

REVISED

PUBLIC

DIRECT TESTIMONY

of

DAVID SACKETT

ECONOMIC ANALYST

Policy Program  
Policy Division  
Illinois Commerce Commission

Petition to Review Affiliate Interactions with Peoples Energy Home Services  
pursuant to January 10, 2012 Rate Order and Investigation into interactions with affiliates

North Shore Gas Company and The Peoples Gas Light and Coke Company

Docket Nos. 12-0273/13-0612 (Cons.)

August 21, 2014

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1 **I. Witness Qualifications**

2 **Q. Please state your name and business address.**

3 A. My name is David Sackett. I am employed by the Illinois Commerce  
4 Commission, 527 East Capitol Avenue, Springfield, Illinois, 62701.

5  
6 **Q. What is your current job title?**

7 A. I am employed as an Economic Analyst in the Policy Program of the Policy  
8 Division of the Illinois Commerce Commission ("Commission" or "ICC").

9  
10 **Q. What are your responsibilities within the Policy Division – Policy**  
11 **Program?**

12 A. I provide economic analysis and advise the Commission and other Staff  
13 members on issues involving the utility industries. I review tariff filings and  
14 make recommendations to the Commission concerning those filings. I  
15 provide testimony in Commission proceedings. I am one of the primary  
16 Staff experts on affiliate issues.

17  
18 **Q. State your educational background.**

19 A. I graduated from Kankakee Community College with an Associate of  
20 Science degree in Arts and Sciences in 1998. I graduated with highest  
21 honors from Illinois State University with a Bachelor of Science degree in  
22 Economics and History in 2000. I obtained a Master of Science degree in  
23 Applied Economics from Illinois State University in the Electric, Natural Gas

and Telecommunications Economics sequence in 2002.<sup>1</sup> I also completed an internship at the Commission in the Energy Division in 2001.

**Q. Describe your professional experience.**

A. Since July 2007, I have been an Economic Analyst in the Policy Program of the Commission's Energy and Policy Divisions. During that time I have participated in numerous docketed proceedings before the Commission. Of particular note has been my testimony dealing with affiliate issues. Most recently, I filed testimony in Nicor Gas Company's Operating Agreement docket (Docket No. 09-0301 consolidated with Docket No. 11-0046, in which Nicor Gas Company sought approval of its reorganization), Docket Nos. 11-0280 and 11-0281 (Cons.) (North Shore Gas Company and The Peoples Gas Light and Coke Company rate proceedings), Docket Nos. 11-0561/0562/0563/0564/0565/0566 (Cons.) (the rate proceeding for certain Utilities Inc. water companies), Docket No. 11-0767 (the Illinois-American Water Company rate proceeding), Docket No. 12-0299 (North Shore Gas Company and The Peoples Gas Light and Coke Company proposal to enter into an affiliated interest agreement with its affiliate ITF) and Docket Nos. 12-0511 and 12-0512 (Cons.) (North Shore Gas Company and The Peoples Gas Light and Coke Company rate proceedings).

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<sup>1</sup> "The Electricity, Natural Gas, and Telecommunications Sequence is a structured program that combines training in basic economic theory and statistical methods with specialized training in the theory, history and institutions of the economics of regulation." <http://www.econ.ilstu.edu/grad/program.htm>.

Prior to joining the Commission, I was an instructor at Illinois State University from 2003 to 2006, where I taught various courses in economics and statistics to undergraduate students. I retired in July of 2014 as a Major from the Marine Corps Reserve after more than 21 years of service in the Infantry; I have completed two combat deployments to Iraq.

## **II. Purpose of Testimony and Background Information**

### **Q. What is the subject matter of your direct testimony?**

A. This testimony concerns an investigation requested by Staff and ordered by the Commission into The Peoples Gas Light and Coke Company's ("Peoples Gas") and North Shore Gas Company's ("North Shore") (jointly, "Companies") interactions with their various affiliates. My testimony also responds to the direct testimony of Companies' witnesses Ms. Linda M. Kallas (NS-PGL Ex. 1.0) and Mr. Jerard Julian (NS-PGL Ex. 2.0) filed in Docket No. 12-0273.

### **Q. Do you have any attachments to your testimony?**

A. Yes. I have attached the following to my testimony:

**Table 1 – List of Attachments**

Att Ltr	Source
A	Email from Allan. Ikoma, Manager, Rates for Peoples Gas and North Shore to Joan Howard, March 24, 2003
B	North Shore <u>Response to Staff</u> Data Request <u>Peoples Energy Protection Plus Program</u> <del>("DR") response</del> from 2004
C	Companies Response to Staff DR Docket Nos. 11-0280/0281 (cons.) DAS-10.01

Docket Nos. 12-0273/13-0612 (Cons.)  
ICC Staff Exhibit 1.0 Rev. (Public)

D	Companies Response to Staff DR Docket Nos. 11-0280/0281 (cons.) DAS-9.09
E	Companies Response to Staff DR DAS-13.01
F	Companies Supplemental Response to Staff DR DAS-13.05
G	Companies Response Staff DR DAS- 19.03
H	Companies Response to Staff DR Docket Nos. 11-0280/0281 (cons.) DAS-2.12
I	Companies Response to Staff DR DAS-19.01
J	Companies Response to Staff DR Docket No. 12-0299 DAS-1.01
K	Companies Response Staff DR DAS-24.02
L	Companies Response to Staff DR DAS-20.01
M	Companies Response to Staff DR DAS-14.09
N	Companies Supplemental Response to Staff DR DAS-10.19
O	Companies Response to Staff DR DAS-15.02
P	Companies Confidential Response to Staff DR DAS-10.18
Q	Companies Response to Staff DR Docket Nos. <del>12-0511/0512 (cons.)</del> <u>12-0299</u> DAS-7.02
R	Companies Response to Staff DR DAS-23.03
S	Companies Response to Staff DR DAS-10.19
T	Companies Supplemental Response to Staff DR DAS-18.01
U	Companies Response to Staff DR RWB-1.03 (CONF)
V	Peoples Gas Response to Staff DR Docket Nos. 12-0511/2c.DAS-11.04
W	Peoples Gas Response to Staff DR Docket Nos. 12-0511/2c.DAS-10.01 (CONF)
X	Companies Response Staff DR DAS-25.02

Y	Companies Response to Staff DR DAS-26.02
Z	Companies Response to Staff DR DAS-22.02
AA	Companies Response to Staff DR Docket No. 12-0299 DAS-7.02
AB	Companies Supplemental Response to Staff DR DAS-18.03
AC	Companies Third Supplemental Response to Staff DR DAS-10.12
AD	Companies Response to Staff DR DAS-26.04
AE	Companies Response to Staff DR DAS-18.02
AF	Companies Supplemental Response to Staff DR DAS-23.01
AG	Companies Response to Staff DR DAS-21.04
AH	Companies Response to Staff DR DAS-16.01
AI	Companies Supplemental Response to Staff DR Docket No. 12-0299 DAS-7.01
AJ	Peoples Gas Response to Staff DR Docket No. 12-0299 DAS-9.02
AK	Companies Supplemental Response to Staff DR DAS-11.01
AL	Companies Response to Staff DR DAS-15.03
AM	Companies Response to Staff DR DAS-15.11
<u>AN</u>	<u>Staff Rider to the Master Affiliated Interest Agreement</u>

### III. Summary of Conclusions and Recommendations

**Q. Please summarize your conclusions and recommendations.**

A. Through affiliate interest transactions, the Companies have a history of abuses of the public interest that require the Commission to act now to

protect the public interest going forward. In particular, Peoples Gas has acted against the public interest as follows:

1. Peoples Gas provided services for Peoples Natural Gas Vehicle Corporation ("PNGV Corp." under the Intercompany Service Agreement ("ISA") that were not provided at cost as required by the ISA.

2. Peoples Gas interacted with Pinnacle CNG Systems, LLC ("Pinnacle") preferentially before it became an affiliate.

3. Peoples Gas interacted with Pinnacle after it became an affiliate under an agreement that had not been approved by the Commission.

4. Peoples Gas interacted with Pinnacle under the Services and Transfers Agreement ("STA") after it became an affiliate but before it was properly added to the STA.

5. Peoples Gas interacted with Integrys Transportation Fuels after it became an affiliate but before it was properly added to the STA.

6. Peoples Gas attempted to include in its rates costs for Pipeline Protection Program ("PPP") solicitation services provided by Integrys Business Support ("IBS") at no charge to Peoples Energy Home Services ("PEHS").

7. Peoples Gas charged PEHS PPP billing charges below cost by not increasing those charges when postage rates increased.

8. Peoples Gas increased charges for repairs to customer-owned piping to ratepayers at an amount that more than double its costs and charged PEHS PPP repairs charges at cost. This provided PEHS with a competitive advantage by disadvantaging ratepayers.

9. Peoples Gas discriminated against ratepayers who did not purchase PPP in the provision of repairs to customer-owned piping by providing firm<sup>2</sup> repair services to PEHS but not ratepayers without PPP.

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<sup>2</sup> Firm repair services are those provided without interruption or in every case requested.



Similarly, North Shore has acted against the public interest as follows:

1. North Shore attempted to include in its rates costs for PPP solicitation services provided by IBS at no charge to PEHS.

2. North Shore charged PEHS billing charges for PPP below cost by not increasing those charges when postage rates increased.

3. North Shore increased charges for repairs to customer-owned piping to ratepayers more than double its costs and charged PEHS PPP repairs charges at cost. This provided PEHS with a competitive advantage by disadvantaging ratepayers.

4. North Shore discriminated against ratepayers who did not purchase PPP in the provision of repairs to customer-owned piping by providing firm repairs services to PEHS but not ratepayers without PPP.

It is my opinion that the current set of Affiliated Interest Agreements ("AIAs") does not adequately protect that public interest and that modifications are necessary to prevent further abuse. The Commission should increase its oversight of these affiliate transactions going forward. Therefore I recommend for the Commission take the following actions:

Rec. 1. Require that the Master Affiliated Interest Agreement ("Master AIA"), that was approved in Docket No. 10-0408 be modified by adding a Rider (Attach. AN) applicable to all Integrys Utilities in Illinois which stipulates that the Companies will only provide services to and receive services under the Master AIA from regulated affiliates (as outlined in Section C.I) and the Companies will not provide services to nor receive services from unregulated affiliates (as outlined in Section C.II). Thus, any interactions with any unregulated affiliates, apart from the IBS Regulated AIA, would require direct Commission approval.

Rec. 2. Prohibit any affiliate or its agent from using information, including but not limited to ratepayer lists, received or developed pursuant to the provision of services to the Companies from soliciting, marketing or

otherwise attempting to provide any product or service directly or indirectly to the Companies' ratepayers or providing such information to any third party whether affiliated with the Companies or not.

Rec. 3. Consider whether fines should be imposed upon the Companies for specific Company actions set forth below which violated the Act to discourage future improprieties by the Companies and/or other utilities.

#### **IV. Introduction and Background**

##### **A. Profit-maximizing firms**

**Q. How can comparing the incentives that profit-maximizing utility faces with those incentives that an unregulated firm faces provide valuable perspective?**

A. To understand the effect the corporate relationship has on the behavior of utilities, one can compare the actions of a normal profit-maximizing firm with those actions that a profit-maximizing utility takes under certain circumstances. Adding in corporate relationships illustrates the complexities required to protect the public interest.

**Q. How do profit-maximizing utilities typically behave?**

A. Profit-maximizing firms generally behave in a manner consistent with maximizing profits subject to certain constraints. A rate-regulated utility ("Utility") is a profit-maximizing firm or business that seeks to maximize its profits. When a Utility interacts with an unaffiliated firm, it often seeks to get the best deal that it can for its bottom line.

**Q. How do incentives change when a Utility is part of a utility holding corporation?**

A. If the Utility is a part of a utility corporation holding company, then it generally seeks to maximize the collective profit of the utility holding company and all of its subsidiaries and affiliates. Thus, the incentives for a Utility that is part of a utility holding company differ from those of a profit maximizing firm with no affiliates.

**Q. Please describe some behavior that a Utility might engage in that would raise the collective profits of its utility holding company and its subsidiaries and affiliates.**

A. A Utility can take actions to increase the collective profits of it and its subsidiaries and affiliates if the regulated Utility interacts with its parent and affiliates such that profits accrue to affiliates that are unregulated rather than to the Utility subject to regulatory earnings constraints. This involves, for example, the shifting of cost from the unregulated affiliate to the Utility or conversely, the shifting of revenues from the Utility to its affiliates. A Utility can also positively affect the holding company bottom line by shifting risk from unregulated affiliates to itself. The Utility can also leverage any market advantage it has (e.g., by being the sole distributor of gas in an area) to provide preferential treatment that allows the affiliate to gain a competitive advantage in some other market.

177 **B. Affiliated Interests and the Public Utilities Act**

178 **Q. Are Utilities un-restrained in succumbing to these incentives?**

179 A. No. There are legal requirements and regulatory and ethical pressures that  
180 constrain the actions of Utilities.

181

182 **Q. Please describe the regulatory pressures relating to transactions with**  
183 **affiliates.**

184 A. Utilities face considerable pressure from various regulatory agencies that  
185 regulate the utility's actions. This regulatory oversight pressures Utilities to  
186 act within the law, even when it may not be the most financially beneficial  
187 option.

188

189 **Q. Please describe the ethical pressures requirements regarding**  
190 **transactions with affiliates.**

191 A. In addition to the regulatory pressures that Utilities face, there also ethical  
192 actions that individual employees play in following the law, corporate policy  
193 and Utility policy. Not all employees are willing to compromise their own  
194 morals or ethical principles to make the corporation more profitable, despite  
195 the personal benefits such profit would have for them.

196

197 **Q. How does the Public Utilities Act ("Act") govern the interactions**  
198 **between public utilities and their affiliated interests?**

A. While I am not an attorney, it is my understanding that the Act imposes requirements with respect to interactions between public utilities and their affiliates. For instance, Section 7-101 of the Act governs transactions between public utilities and their affiliates. It provides that no contract between a Utility and its affiliate is effective until it has been filed with and consented to or excepted by the Commission.

No management, construction, engineering, supply, financial or similar contract and no contract or arrangement for the purchase, sale, lease or exchange of any property or for the furnishing of any service, property or thing, hereafter made with any affiliated interest, as hereinbefore defined, shall be effective unless it has first been filed with and consented to by the Commission or is exempted in accordance with the provisions of this Section or of Section 16-111 of this Act. The Commission may condition such approval in such manner as it may deem necessary to safeguard the public interest. If it be found by the Commission, after investigation and a hearing, that any such contract or arrangement is not in the public interest, the Commission may disapprove such contract or arrangement. Every contract or arrangement not consented to or excepted by the Commission as provided for in this Section is void.

220 ILCS 5/7-101(3) (emphasis added).

**Q. Does this subsection apply equally to services provided by the Utility to the affiliate as well as to services provided by the affiliate to the Utility?**

A. Yes. While I am not an attorney, I understand that Section 7-101 applies to all transactions between Utilities and their affiliates regardless of which entity provides services to the other, unless notice of those transactions are filed with and consented to by the Commission or are excepted in

accordance with the provisions of Section 7-101 or of Section 16-111 of the Act.

**Q. What types of approval does the Act allow?**

A. The Act allows the Commission some flexibility in its approval. First, in accordance with the Act, the Commission has set forth rules governing the interactions between Utilities and their affiliates. These rules provide additional guidance on what is an acceptable transaction. The rules allow the waiver of filing and the waiver for consent and approval of certain contracts. 83 Ill. Admin Code Part 310. Second, the Commission can provide blanket / generic approval of transactions for certain types of services provided according to specific charges through agreements called Affiliated Interest Agreements or ("AIAs"). Any contract or arrangement that does not fall into one of the above mutually exclusive categories must be approved by the Commission or the contract or arrangement is not effective and void.

**Q. Please describe AIAs further.**

A. AIAs refer to general agreements that allow for an on-going provision of services between affiliates. AIAs may also provide for sub-agreements for the services approved by the Commission in the AIA and for charges in compliance with the terms of the AIA to be entered into with parties to the AIA without subsequent Commission approval.

|

253 **Q. What is a service company?**

254 A. A service company provides services such as customer service or accounting  
255 to other affiliates. In most cases this service company is part of a Utility's  
256 holding company system. In some cases, those service companies provide  
257 services to only regulated affiliates. In other cases, however, those service  
258 companies provide services for regulated and unregulated affiliates alike. In  
259 the latter case, the potential for subsidization of unregulated affiliates by the  
260 Utilities increases.

261

262 **Q. Are the Companies currently parties to any AIAs?**

263 A. Yes. The Commission has approved several AIAs for Peoples Gas and North  
264 Shore. The Commission has approved an agreement between the  
265 Companies and the Integrys corporate service company IBS called the IBS  
266 Reg AIA in Docket No. 07-0361.<sup>3</sup> Additionally, the Commission approved the  
267 current general AIA<sup>4</sup> that affects services between Peoples Gas, North Shore,  
268 and all their Integrys affiliates which is referred to as the Master AIA, in Docket  
269 No. 10-0408<sup>5</sup>.

270

271 **Q. Are there any other AIAs that are relevant to this investigation?**

272 A. Yes. The Commission approved the ISA in Docket No. 55071 between the  
273 Companies and Peoples Energy Corporation and several of its subsidiaries.

---

<sup>3</sup> This AIA is the primary agreement by which the Companies receive services from its affiliate IBS. It is a one-way agreement in which IBS provides the Companies for services but not vice-versa.

<sup>4</sup> Called the Non-IBS AIA.

Later, the ISA was replaced by the STA between the Companies and Peoples Energy Corporation and all of its subsidiaries which was approved by the Commission in Docket No. 06-0540.<sup>6</sup> The STA was then replaced by the Master AIA.

**Table 2 – The Companies’ Significant AIAs**

Name	Docket No.	Significant Parties	Effective dates	Cost Basis
ISA	55071	Peoples Gas North Shore and PEC	8/1/1969 - 2/6/2007	Reasonable Cost
STA	06-0540	Peoples Gas North Shore and PEC	7/7/2007 - 12/31/2013	FDC
IBS Non-reg AIA	07-0361	Peoples Gas North Shore and IBS	12/7/2007 - Current	FDC
Master AIA	10-0408	Peoples Gas North Shore and all Integrys affiliates	1/1/2014 - Current	Market or FDC

<sup>6</sup> The STA was in effect from 2/7/2007 to 12/31/2013.



**C. Issues leading to the investigation.**

**Q. What events precipitated this investigation?**

A. In Docket Nos. 11-0280/0281 (Cons.), I raised several objections to the Companies support of an unregulated affiliate Peoples Energy Home Services (“PEHS”) and its Pipeline Protection Plan (“PPP”) gas line warranty product. See North Shore Gas Co. and The Peoples Gas Light and Coke Co., ICC Final Order Docket Nos. 11-0280/0281 (Cons.), 88-98(January 10, 2012) (“2011 Rate Case”). The Commission ordered an adjustment and directed an investigation into the Companies continued support of PEHS. Id. at 98. That investigation began as Docket No. 12-0273. Subsequent to that order, I became aware of additional affiliate interactions that did not appear to be in the public interest. I filed a Staff Report requesting that the Commission expand the scope of this investigation to consider all affiliate interactions and remedies. The Commission ordered an expansion of the investigation as Docket No. 13-0612 and that the two investigations be consolidated. North Shore Gas Co. and The Peoples Gas Light and Coke Co., ICC Order Initiating Proceeding Docket No. 13-0612, 2 (November 6, 2013).

**Q. Did the Companies file testimony with its initial filing in Docket No. 12-0273?**

A. Yes. The Commission ordered the Companies to address two issues in testimony: solicitation of ratepayers for affiliated products and repair charges

to ratepayers not on PPP. I will address all issues relating to the Companies  
direct testimony in Docket No. 12-0273 below in the section related to PEHS.

**V. The Companies interactions with unregulated affiliates that are not in  
the Public Interest**

**Q. Please indicate which instances of the Companies' interactions with  
their affiliates that you believe are not in the public interest.**

A. There have been several instances of improprieties found by the  
Commission. Following an evaluation of the factual circumstances in each  
matter, the Commission found impropriety between the Companies and  
their affiliate Peoples Energy Home Services (2011 Rate Case Final Order  
at 93) and between Peoples Gas and its affiliate Enovate, LLC., ("enovate")  
a company jointly owned by Peoples Energy Corporation and Enron (The  
Peoples Gas Light and Coke Co., ICC Final Order Docket No. 01-0707, 144  
(March 28, 2006)). Below, I discuss the history of these inappropriate  
interactions and provide evidence regarding additional improprieties  
between the Companies and PEHS. Additionally, I have uncovered  
evidence of behavior inconsistent with the public interest with respect to  
Peoples Gas and two affiliates in the Compressed Natural Gas ("CNG")  
services industry – Pinnacle and PNGV Corp., which I explain further below.

**Improper interactions with affiliates by Peoples Gas and North Shore.**

**Q. Has the Commission ever found the Companies to have engaged in improper behavior with affiliates?**

A. Yes. There have been at least two instances of impropriety by the Companies which the Commission has clearly reviewed the record and found against them. The most recent example of this is the Companies and their affiliate IBS and the interaction of these firms with PEHS. The second example is the interaction of Peoples Gas with enovate. Below, I explain these improper interactions with PEHS and provide additional evidence regarding improper interactions between the Companies and PEHS not previously presented to the Commission.

**1. Peoples Energy Home Services and the Pipeline Protection Plan**

**Q. Please describe the history of the relationship between the Companies, Peoples Energy Home Services, and its Pipeline Protection Plan?**

A. In March 2003 Peoples Gas and North Shore approached the Commission Staff to inform them of their intent to create a gas line warranty program to be offered by the Companies. (Attach. A, Email from Allan. Ikoma, Manager, Rates for Peoples Gas and North Shore to Joan Howard, March 24, 2003.) In 2004, the Companies informed Staff that instead of being offered by the Companies, PEHS was offering the gas line warranty program. "The parent company, Peoples Energy Corporation, reviewed options for offering the

service and considered potential risks (losses), and rewards (profits) and determined that the best interests of shareholders and ratepayers would be served in offering the program, for both PGL and NGS through PEHS.” (Attach. B, North Shore Response to Staff Data Request (“DR”) Peoples Energy Protection Plus Program response from 2004, 3.)

**Q. What services did the Companies provide for PEHS?**

A. From 2004 to 2007, the Companies provided billing, repairs, solicitation, customer service and marketing services to PEHS in support of PEHS warranty products, mainly PPP, a warranty on in-side gas lines. PEHS had no employees and was, thus, dependent upon the Companies to perform these services. All interactions between the Companies and PEHS were governed initially pursuant to the ISA and subsequently under the STA.<sup>7</sup> Both AIAs required that PEHS pay the Companies’ for all services provided by the Companies’ to PEHS at cost.

From 2008 to 2012, the Companies continued to provide repairs, while IBS provided billing, solicitation, and customer service to PEHS.<sup>8</sup>

**Q. When did the issue of the Companies’ charges to PEHS become a matter of interest to the Commission?**

---

<sup>7</sup> After February 7, 2007.

<sup>8</sup> IBS provided services to PEHS under the IBS Non-Reg AIA which requires all services to be provided at Fully Distributed Cost.

A. In the 2011 Rate Case, the Companies admitted that IBS had failed to charge PEHS for either solicitations or customer service from 2008 through August 2011. (Attach. C, Companies Response to Staff DR Docket Nos. 11-0280/0281 (Cons.) DAS-10.01(b).) The Companies indicated the problem had been corrected and IBS would charge PEHS appropriately going forward. (Attach. D, Companies Response to Staff DR Docket Nos. 11-0280/0281 (Cons.) DAS-9.09.)

**Q. Did the Commission's Final Order in the 2011 Rate Case address the issue of solicitation charges to PEHS?**

A. Yes; the Commission determined that IBS had not charged PEHS for solicitation expenses, and ordered an adjustment:

The Commission agrees with Staff and accepts Staff witness Sackett's proposed adjustment to the expenses billed to the Companies from their affiliated service company IBS. The evidence supports the conclusion that IBS failed to charge PEHS for services IBS performed for it related to the PPP according to its effective affiliate agreements and failed to credit the Companies for those revenues. This failure by IBS to recognize revenues for services it provides to certain affiliates does, in fact, have the end result of IBS over charging the Companies for services provided by IBS to the Companies. We find that Staff's adjustment based on the margin of \$656,267 and \$116,361 that PEHS makes on PPP for Peoples Gas and North Shore reasonable.

2011 Rate Case Final Order at 93.

**Q. Did the Commission's Final Order in the 2011 Rate Cases address the issue of an investigation of the Companies' interactions with affiliates?**

**A.** Yes. The Commission found that the Companies acted improperly with their affiliates to the detriment of ratepayers and ordered an investigation to prevent continuing subsidization of affiliates by ratepayers. The Commission ordered this investigation, as requested by Staff, stating:

The Commission agrees with Staff and finds that the Utilities have not properly interacted with their affiliates as evidenced by our conclusions in the above related sections. Staff's proposal for further Commission investigation of the Utilities' interactions with their affiliates is warranted and in the public interest. We believe that the investigation is necessary to prevent ratepayers from continuing to subsidize the affiliates.

On December 15, 2010, this Commission approved a Master Affiliated Interests Agreement (Master "AIA") by its Order in Docket No. 10-0408 that has not yet become effective. The Companies argue that the Services and Transfer Agreement ("STA") is still in effect and allows the Utilities to provide the solicitation services for the nonregulated affiliates; however, the language that specifically allows the provision of solicitation services is not included in the Master AIA. Since it is now clear that the Utilities intend to continue the provision of solicitation services even under the Master AIA when it becomes effective and the Commission finds that the Utilities have not properly interacted with their affiliates in the provision of services under the STA, it is necessary for the Commission to render a more direct conclusion on the provision of solicitation services to affiliates.

Id. at 98.

**Q. What new information about PEHS was provided by the Companies in their direct testimony filed in Docket No. 12-0273?**

|

430 A. The Companies' direct testimony informed the parties and the Commission of  
431 the discontinuation of PPP in 2012. (NS-PG Ex. 1.0, 3, 11.) Subsequently, a  
432 data request response indicated that IBS ceased solicitation of PPP on June  
433 8, 2012. (Companies Response to Staff DR DAS-1.03(c).) PEHS sent letters  
434 (Companies Response to Staff DR DAS-3.01(e) Attach 01) to its customers  
435 notifying them of the end of PPP on July 16, 2012 (Companies Response to  
436 Staff DR DAS-16.04(b)).

437

438 **Q. What is the Companies' assertion regarding IBS charges to PEHS**  
439 **following the Commission's order to do so in the 2011 Rate Case?**

440 A. Ms. Kallas states that IBS "charges PEHS at cost." (NS-PG Ex. 1.0, 10.)

441

442 **Q. Is this statement by Ms. Kallas that IBS charged PEHS at cost correct?**  
443 **Please explain.**

444 A. No. The materials provided by the Companies in response to data requests  
445 show that Ms. Kallas' response is incorrect. First, when Ms. Kallas' direct  
446 testimony was filed in April 2012, IBS was not charging PEHS for on-going  
447 solicitation services. (Attach. E, Companies Response to Staff DR DAS-  
448 13.01(a).) Though the Companies had indicated the problem had been  
449 corrected and IBS would charge PEHS appropriately going forward, IBS never  
450 followed through on that promise. (Attach. D, Companies Response to Staff  
451 DR Docket Nos. 11-0280/0281 (Cons.) DAS-9.09(c).) Second, IBS never

went back and required PEHS to pay for the 3 missed years. (Attach. F Attach 02 to the Companies Supplemental Response to Staff DR DAS-13.05.) When IBS finally did charge PEHS for service, it ended up charging PEHS only \$18,507 for what amounted to four and a half years of solicitation. IBS budgeted \$16,572 for a single year for the 2012 test year. 2011 Rate Case Final Order at 88. Thus, the final billing reflects a significant reduction from the budget. Third, IBS never charged PEHS for overheads<sup>9</sup> for any of the four and a half years that it provided services to PEHS.<sup>10</sup> (Attach. F, Attach 02 to the Companies Supplemental Response to Staff DR DAS-13.05.) Fourth, while solicitation of new customers ceased in June 2012, IBS continued to provide call center services to active customers through September 2012 and invited calls to the call center to discuss the closing. (Companies Response to Staff DR DAS-3.01(e) Attach 01.) It is reasonable to assume that this would have increased the number and proportion of calls from PPP customers.

**Q. Do you have a conservative estimate for IBS's customer relations costs for PEHS?**

A. Yes. I have used the budget numbers provided by IBS and extrapolated the charges and overheads for each of the years that IBS provided those services. My conservative estimate of those costs is \$124,916. Since IBS actually billed

---

<sup>9</sup> Overheads refers to labor related costs such as pension and health insurance as well as the physical plant structures that are needed to provide services.

<sup>10</sup> Strangely, the Companies bemoan the fact that they inadvertently overcharged PEHS for July 2012. (Attach. E, Companies Response to Staff DR DAS-13.01(a).)



PEHS only \$18,506 over this entire period, PEHS paid less than 15% of these costs. The remaining 85% were absorbed by regulated utilities, including Peoples Gas and North Shore. While Staff was able to get an adjustment for these costs in the 2011 Rate Case, rates from the 2009 Rate Case were not adjusted and included those costs. So ratepayers paid for services provided to PEHS during this time.

**Table 3 – Estimated Cost of Customer Care**

Customer Care				
	Estimated Costs for PEHS			
	Amount			
Year	w/o overheads	Overheads	Total	
Calendar 2008	\$ 25,468 <sup>11</sup>	\$ 4,982 <sup>12</sup>	\$ 30,450	
Calendar 2009	\$ 25,468 <sup>13</sup>	\$ 4,982 <sup>14</sup>	\$ 30,450	
Calendar 2010	\$ 25,468	\$ 4,982 <sup>15</sup>	\$ 30,450	
Calendar 2011	\$ 18,563	\$ 3,631 <sup>16</sup>	\$ 22,194	
Calendar 2012	\$ 14,268	\$ 2,791	\$ 11,373 <sup>17</sup>	19.6%
Total	\$ 109,235	\$ 11,404	\$124,916	
Paid by PEHS	\$ 18,507		14.8%	

**Q. What does Table 3 – Estimated Cost of Customer Care illustrate regarding Integrys and IBS affiliate transactions?**

<sup>11</sup> Estimated using budget amount for 2010. (DAS-13.05 Attach 02)

<sup>12</sup> Overhead estimated using 2012 budget percent of 19.6%. (DAS-13.05 Attach 02)

<sup>13</sup> Estimated using budget amount for 2010. (DAS-13.05 Attach 02)

<sup>14</sup> Overhead estimated using 2012 budget percent of 19.6%. (DAS-13.05 Attach 02)

<sup>15</sup> Overhead estimated using 2012 budget percent of 19.6%. (DAS-13.05 Attach 02)

<sup>16</sup> Overhead estimated using 2012 budget percent of 19.6%. (DAS-13.05 Attach 02)

<sup>17</sup> This number is 8/12<sup>th</sup> of the budgeted amount because IBS only provided service through August 2012.

A. Though the amounts are small, they illustrate Integrys and its affiliates are either incapable or unwilling to follow the requirements of agreements in place to ensure that subsidization does not occur.

**Q. Even though neither of the Companies nor IBS are still soliciting for PEHS, is the issue of solicitation moot?**

A. No. Given the Companies track record with PEHS, I do not think that the Companies should be allowed the option to continue solicitation in the future. As noted above, the Final Order in the 2011 Rate Case requires that this investigation consider the provision of solicitation services to any affiliates, not only PEHS. Thus, the Commission should determine if further solicitation of the Companies ratepayers under the Master AIA is in the public interest.

**Q. What does the Master AIA state regarding solicitation for affiliates?**

A. The Master AIA has two distinct lists of services, one between regulated affiliates and another between regulated and unregulated affiliates. The Master AIA lists solicitation, called “marketing and sales work” as a service that can be provided to or received from regulated affiliates and that same service is absent from the section of services that can be provided to unregulated affiliates.

Appendix C – Services

Subject to the limitations set forth in Section 1.1 and applicable state and federal requirements, a Party may provide to or

receive from any other Party the Services described in this Appendix C.

“Major Services” shall mean Services identified as such in this Appendix C and for which Parties expect that, in the normal course of business and under normal operating conditions, they shall provide on a regular or day-to-day basis. “Incidental Services” shall mean Services identified as such in this Appendix C and for which the Parties expect that, in the normal course of business and under normal operating conditions, they shall provide infrequently or, if provided on a regular or day-to-day basis, shall represent an insignificant amount of intercompany services provided by the Providing Party.

I. Any Regulated Party may provide to or receive from any other Regulated Party the following Services:

Major Services....

3. Customer: Provide customer service; support billing and payment processing; support credit and collections activity; energy conservation support; marketing and sales work.

II. Any Non-Regulated Party may provide to or receive from any Regulated Party the following Services:

Incidental Services....

4. Customer: Provide customer service; support billing and payment processing; support credit and collections activity.

(Attachment to Companies Response to Staff DR DAS-11.04.)

**Q. How did the Companies first address issue of solicitation going forward under the Master AIA?**

A. The Companies initially interpreted the Master AIA to give them the right to solicit for unregulated affiliates. Despite clear difference in the listed services under the category “Customer,” the Companies chose to read that agreement to mean the opposite of what it says. “Please see Appendix C of the Master AIA[ ]. Appendix C includes customer services among services a non-regulated party may provide to or receive from a regulated party. A non-regulated party may provide any service to another non-regulated party.”

(Companies Response to Staff DR DAS-1.01(n) (internal references

omitted).) By expanding the scope of the defined term “Customer,” the Companies found support in the AIA to allow them to provide these services.

**Q. How did the Companies next address issue of solicitation going forward under the Master AIA?**

A. At the same time that the Companies agree to interpret the Master AIA as it clearly read<sup>18</sup> (Companies Supplemental Response to Staff DR DAS-3.01(a)), they assert that they cannot control the actions of their affiliate that provides call center services on their behalf from soliciting their ratepayers for other goods and services for other third parties after completing the official business of the call.

North Shore and Peoples Gas believe that Integrys Business Support, LLC (“IBS”) may, while taking a telephone call from a North Shore or Peoples Gas customer or prospective customer, on that utility’s toll-free telephone line or any telephone line, during that same call, solicit on behalf of or otherwise provide services for Peoples Energy Home Services (“PEHS”). (Companies Response to Staff DR DAS-3.01(f).)

**Q. Did the Companies finally agree in a data request response to prohibit solicitation going forward under the Master AIA?**

---

<sup>18</sup> North Shore and Peoples Gas agree that neither shall construe the term “Customer” as used in Section II of Appendix C of the Master AIA (Attachment 5 of the response to Staff data request DAS 1.01) to include any of the following: marketing, sales, customer solicitation. Section II addresses services that a Non-Regulated Party may provide to or receive from a Regulated Party. Under the Master AIA, North Shore and Peoples Gas shall not provide marketing, sales or solicitation service to a non-utility affiliate or receive such services from a non-utility affiliate. Supplemental Companies Response to Staff DR DAS-3.01a)

|

563 A. Yes. The Companies finally agree that they can assert control over IBS  
564 interactions with Company ratepayers. “North Shore and Peoples Gas  
565 agree that they will direct IBS not to solicit their customers for services  
566 offered by non-utility affiliates for the time being, *i.e.*, subject to an order in  
567 this case.” (Companies Response to Staff DR DAS-6.01.)

568

569 **Q. Did the Companies finally agree in a data request response to prohibit**  
570 **provision of customer information to any affiliate?**

571 A. Yes. At Staff’s request, the Companies also agreed to “not provide  
572 customer information to any affiliate and to instruct IBS to not provide  
573 customer information to any affiliates.” (Companies Response to Staff DR  
574 DAS-6.01.)

575

576 **Q. Did you testify in the Companies’ 2011 Rate Case regarding the issue**  
577 **of charges for repair services provided by the Companies on behalf of**  
578 **PEHS?**

579 A. Yes. As I indicated in my direct testimony in the 2011 Rate Case, the  
580 Company charged rates to its ratepayers for in-home repairs that were  
581 about twice as much as they charged their affiliate PEHS for the same  
582 services. (See 2011 Rate Case, Staff Ex. 18.0, 25.)

583

584 **Q. What was the Commission's finding in the Companies' 2011 Rate Case**  
585 **regarding the issue of charges for repair services provided by the**  
586 **Companies on behalf of PEHS?**

587 A. The Commission determined that the Companies had under-charged its  
588 affiliates for repair services, leading to higher rates for ratepayers, and  
589 ordered an adjustment. The Commission also required that the Companies  
590 charge their affiliate the same repair charges that ratepayers were paying:

591

592 The STA requires that the Utilities charge their affiliates the  
593 pricing mechanism approved by the Commission or, if none  
594 exists, the FDC of providing that service. We find that since the  
595 Companies have not charged the FDC of providing the repair  
596 service, we are now placed in a position to approve an alternate  
597 pricing mechanism. The Commission agrees with Staff and  
598 finds that its adjustments are reasonable. The Utilities shall  
599 charge PEHS the same rate that they charge ratepayers.  
600 Further, the full amount of these repairs should be included in  
601 the test year for Peoples Gas and North Shore respectively.

602

603 2011 Rate Case Final Order at 97.

604

605 **Q. How did the Companies respond to the Commission's direction that the**  
606 **Companies provide an explanation of the charges to ratepayers and**  
607 **charge PEHS the same rates as those ratepayers?**

608 A. Instead of charging PEHS the same higher rates that ratepayers were  
609 paying, the Companies recalculated the repair charges to its ratepayers at  
610 cost (Companies Ex. 2.0, 4-5) and then charged PEHS those same repair  
611 charges. (Companies Response to Staff DR DAS-1.02(e).)

612

|

613 **Q. What was the result of the Companies re-calculation of ratepayer repair**  
614 **charges at cost and why is this result significant?**

615 A. Repairs charges to ratepayers dropped by more than half. While this is a  
616 positive development for ratepayers, it illustrates that the Companies had  
617 increased their charges for repair rates more than 2 times above costs,  
618 making the PPP offered by Companies' unregulated affiliate PEHS more  
619 attractive to ratepayers which were solicited by the call center reps.

620

621 **Q. What is the history of these repair rates?**

622 A. The timing of repair charge increases appear to be targeted to make PPP  
623 more competitive, by making it cheaper relative to Company-provided repairs.  
624 Recall that the Companies had first notified Staff in March 2003 via email that  
625 they were planning to offer PPP as their own product. During that email, the  
626 Companies state that the repair rate is \$40 for the first 30 minutes.<sup>19</sup> (Attach.  
627 A, Email from A. Ikoma to J. Howard, March 24, 2003.) The very next month,  
628 those repair rates were raised to \$60. By July 2005 both Companies had  
629 reached the \$70 level. This remained in effect until January 2013. (Attach. G,  
630 Companies Response Staff DR DAS- 19.03.)

631

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<sup>19</sup> Note that this is more than 30% above the 2012 cost-based rates. So the Companies were already profiting from these services.

632 **Q. How did the Companies use their ratepayer repair rates to benefit**  
633 **PEHS?**

634 A. The Companies used this repair rate in its script where it states,

635 Now that we have your order completed Mr./Ms.\_\_\_\_\_,  
636 I'd like to offer you the Peoples Energy Protection Plus program  
637 which is offered through Peoples Energy Home Services, an  
638 affiliate of Peoples Gas.

639 For only \$2.95 per month, repairs to inside leaks on your  
640 exposed pipes and appliance connectors will be covered at no  
641 charge for up to \$300. All work is guaranteed by this program.  
642 Without this coverage, repairs to inside gas leaks would cost a  
643 minimum of \$70 for the first ½-hour of service.

644 'Would you be interested in enrolling?'

645  
646 (Companies responses to Staff DR Docket Nos. 11-0280/0281  
647 (Cons.) DAS 2.09 and Att. 01.)  
648

649 **Q. Did the Companies deliberately increase charges to ratepayers above**  
650 **cost to benefit PEHS at ratepayers' expense?**

651 A. It is impossible to know if the Companies did this deliberately to help their  
652 affiliate while disadvantaging its ratepayers; however, it certainly had that  
653 effect. The Companies actions made the PPP more favorable to Company-  
654 provided repairs services than it would have been otherwise.

655

656 **Q. How does this evidence settle the question about the margin in those**  
657 **\$70 charges?**

658 A. According to the Companies, repair charges for ratepayers included a  
659 "markup" for profit margin. (Docket No. 11-0280/0281 (Cons.), Staff Ex. 18.0,



Attachment H - Companies responses to Staff DR DAS 9.08.) Given the reduction in rates as a result of the new cost study, despite the Companies' witness, Ms. Gregor's estimate that the margin was between 10-20% (Docket No. 11-0280/0281 (Cons.), Companies responses to Staff DR DAS 13.02), it appears that this margin was actually more than 100% (NS-PG Ex. 2.1).

**Q. What additional evidence is there, which has not been previously presented to the Commission, regarding discriminatory provision of repair services?**

A. Another issue that arises is the diminished repair services that ratepayers receive relative to PEHS. PEHS has no employees of its own; thus, all actions that it took were done either by its officers or utility employees acting on its behalf. As indicated in Ms. Kallas' testimony, the Companies will only make non-PPP repairs in some cases:

Q. If a customer requires repairs to customer-owned piping and the customer does not purchase the PPP service, will the Utilities repair the piping?

A. If the customer requests, the Utilities provide this service in some cases, but the Utilities have no obligation to provide the service. Also, the customer may contract with others for the service.

(NS-PGL Ex. 1.0, 5.)

As explained further in Mr. Julian's testimony, the Companies will only make non-PPP repairs if the tech has the time and parts to make those repairs on the spot.

Q. If a customer asks the Utilities to repair customer-owned piping, what do the Utilities consider in determining whether to make the repair?

A. Before agreeing to make the repair, the Utilities consider the nature of the repair, such as the amount of time and material that would be required, as well as other workload requirements, to determine if resources are available to make the repair.

(NS-PGL Ex. 2.0, 4.)

**Q. How did the Companies respond when asked if limitations on repairs are the same for PPP as non-PPP customers?**

A. When asked if the limitations on repairs are the same for PPP as non-PPP customers, the Companies answered that there is a difference because, “[s]ervice to PPP customers is subject to a contract” (Companies Response to Staff DR DAS-2.03(a)) between the customer and PEHS, not between the Companies and PEHS (Companies Response to Staff DR DAS-3.03). According to the Companies, service orders to non-PPP ratepayers who need those repairs are sometimes turned down by the techs. (NS-PGL Ex. 1.0, 5.)

**Q. Did the PEHS use any contractors for any repairs?**

A. No. All repairs to PEHS customers’ customer-owned piping were completed by utility employees. Contractors were not used. (Attach. H, Companies Response to Staff DR Docket Nos. 11-0280/0281 (Cons.) DAS-2.12.)

713 **Q. Does this indicate discrimination by the Companies?**

714 A. Yes. For all intents and purposes, the Companies were providing repair  
715 services to their affiliate, PEHS, that were superior to those provided to  
716 ratepayers that do not have PPP, and thus, discrimination occurred.<sup>20</sup>

717

718 **Q. Does the Act address discrimination?**

719 A. Yes. The Act sets forth broad requirements for utilities that would provide  
720 services under the Act. Section 8-101 of the Act delineates  
721 “nondiscrimination” as one of the “[d]uties of public utilities.” 220 ILCS 5/8-  
722 101. “A public utility shall, upon reasonable notice, furnish to all persons who  
723 may apply therefor and be reasonably entitled thereto, suitable facilities and  
724 service, without discrimination and without delay.” *Id.* (emphasis added).

725

726 **Q. Does this discrimination by the Companies violate the Commission**  
727 **Rules?**

728 A. Yes. Section 550.20 of the Commission’s Rules, titled Non-Discrimination,  
729 generally prohibits discrimination in a broad range of actions by utilities in their  
730 interactions with affiliated interests. 83 Ill. Adm. Code § 550.20. There are

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<sup>20</sup> Not only did PEHS get a higher grade of service, they were charged half of what the Companies charged ratepayers for the exact same repairs. If PEHS received a higher grade of repair service relative to that provide for non-PPP customers then they should have paid a premium for this service. As it was, PEHS was charged only the FDC for a standard repairs service. It is ironic that the utilities charged a premium price to its ratepayers for the inferior service. The Commission already determined that the utility must charge the same price to its affiliate as it charges to its ratepayers in the 2011 rate case.

three categories of entities identified and defined in Section 550.10: utilities, affiliated interests and un-affiliated entities (i.e., everybody else). Section 550.20 states:

Gas utilities shall not provide affiliated interests or customers of affiliated interests preferential treatment or advantages relative to unaffiliated entities<sup>21</sup> or their customers in connection with services provided under tariffs on file with the Illinois Commerce Commission (Commission), including contracts filed under tariffs filed pursuant to Section 9-102.1 of the Act [220 ILCS 5/9-102.1]. This provision applies broadly to all aspects of service, including, but not limited to, responsiveness to requests for service, the availability of firm versus interruptible services, the imposition of special metering requirements, and all terms and conditions and charges specified in the tariff.

83 Ill. Adm. Code 550.20(a) (emphasis added).

Furthermore, sub-section (d) states, “A utility shall process requests for similar services provided by the utility in the same manner and within the same time period for its affiliated interests or their customers as for unaffiliated entities.”

83 Ill. Adm. Code 550.10(d) (emphasis added).

**Q. Did PEHS make a request for repair services under the ISA?**

A. Yes. The Companies processed a request for repair services from PEHS on an expedited or more concrete basis that are similar to the repair services that they provided for ratepayers. The Companies could not have provided any

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<sup>21</sup> The Rules define an unaffiliated entity as “any entity other than either the gas utility or any of the gas utility's affiliated interests.” Since an “entity” is “something that exists by itself,” ratepayers are unaffiliated entities.

service under the ISA without first receiving a request from PEHS to perform repairs services and the Companies agreeing to do so.

1. Upon request made from time to time by any party to this Agreement (hereinafter referred to as the "requesting party") to any other party hereto' (hereinafter referred to as the "requested party"), said requested party agrees to perform, within a reasonable time of the request thereof, any of the following acts: .... provided, however, that the requested party shall be under no obligation to perform any of the foregoing acts if, in its individual judgment and discretion, the performance thereof would in any way impair the ability of said requested party to fully discharge its corporate functions, or any of its functions subject to regulation. (Attachment to the Companies Corrected Response to Staff DR Docket No. 12-0299 DAS-7.01(k), 2-3.)<sup>22</sup>

**Q. Did the Companies enter into any MOU or contract other than the ISA?**

A. No. The Companies that indicated that there was no MOU or contract between themselves and PEHS; rather they bound themselves voluntarily in a verbal agreement to provide expedited concrete repair services to PEHS.

No, North Shore and Peoples Gas were not obligated to provide services that Peoples Energy Home Services requested. No contract or MOU existed that created an obligation. The Services and Transfers Agreement allowed Peoples Energy Home Services to request a service from North Shore and Peoples Gas, and North Shore and Peoples Gas had the right to provide or refuse to provide the service.

(Companies Response to Staff DR DAS-11.03(b).)<sup>23</sup>

**Q. What was the effect of the discriminatory repair services coupled with the lower repair rates?**

<sup>22</sup> Note also that under this agreement the Companies had a right to refuse to provide any service.

<sup>23</sup> The reference to the STA is incorrect because it was not the agreement in effect at the time that the service was initiated. The agreement in effect, the ISA, was approved by the Commission in Docket No. 55071. It offered the same right to provide service. (Companies Response to DR DAS-14.11(d).)

|

788 A. When coupled with the higher charges to ratepayers for the same repairs,  
789 these two actions resulted in PEHS possessing a more attractive product  
790 relative to the utility-provided repair services. According to the Companies,  
791 less than 5% of service orders to non-PPP ratepayers who need those repairs  
792 are turned down by the techs. Id. As the Companies averaged 11,000 repairs  
793 annually between 2005-2010, this could mean as many as 550 customers  
794 annually were denied services that they would have received if they had  
795 purchased PPP from PEHS. Since PPP ran for 8.5 years, this could be as  
796 many as 4700 customers.

797

798 **Q. Have the Companies agreed to provide ratepayers with cost-based**  
799 **repair rates going forward even now that it no longer performs these**  
800 **repairs for PEHS?**

801 A. Yes. "North Shore and Peoples Gas will continue to provide repair services  
802 to customers under the same terms described in Mr. Julian's direct  
803 testimony (lines 59-64)." (Companies Response to Staff DR DAS-2.02(g).)

804

805 **Q. Have you uncovered any other actions that are not in the public interest**  
806 **with respect to the services provided by the Companies and IBS to**  
807 **PEHS?**

808 A. Yes. Billing Rates were not raised from 2004 when they were set at \$0.40 per  
809 bill. Postage rose four times between 2004 and 2009 for an 18% total  
810 increase. At no time did the Companies increase billing charges to PEHS.

Once questions were raised about it in the 2011 rate case, the charges were finally raised back to cost-level at \$0.54 per bill; at that time the postage was 69% of all charges. Subsequent to this increase, rates again rose 2% in 2012. PEHS still paid the lower charge through September 2013.

**Q. Did the Companies and their affiliate, IBS, make any attempt to follow the Commission-approved AIAs regarding billing charges?**

A. No. Neither the Companies nor IBS made any effort to keep billing rates at cost, despite the Commission's requirements that reasonable cost be paid by PEHS under the ISA and Fully Distributed Costs be included under the STA.

**Q. Did the Companies charge rates to rate payers reflect rising postage costs?**

A. Yes. In each rate case from 2007 to 2012, the Companies included the current postage in their Operating Costs and Revenue Requirement. Additionally, their future test years reflected pending postage increases. (Attach. I, Companies Response to Staff DR DAS-19.01(f) and Attachment.) Therefore, the Companies were quick to ensure that they were made whole for all rising postage rates with respect to their own ratepayers but did not treat their affiliate with the same concern nor did they ensure that their affiliate IBS was fully compensated by PEHS with respect to postage costs IBS incurred in serving PEHS. This ultimately led to higher billing charges

to ratepayers as costs that should have been borne by PEHS were time and again shifted to the Companies.

**Table 4 – Billing Charges to PEHS**

Year	Billing Party	Charges to PEHS	Postage Increases Included in Charges to Ratepayers	Postage Increase Date
2004	Peoples Gas	At Cost		
2005	Peoples Gas	At Cost		
2006	Peoples Gas	Below Cost	07-0241/0242(c.)	8-Jan-06
2007	Peoples Gas	Below Cost	07-0241/0242(c.)	14-May-07
2008	IBS	Below Cost	09-0166/0167(c.)	12-May-08
2009	IBS	Below Cost	09-0166/0167(c.)	11-May-09
2010	IBS	Below Cost		
2011	IBS	At Cost	11-0280/0281(c.)	18-Apr-11
2012	IBS	Below Cost	11-0280/0281(c.)	22-Jan-12
2013	IBS	Below Cost	12-0511/0512(c.)	27-Jan-13

## **2. Peoples Gas and enovate**

**Q. Are you aware of another occurrence of improper affiliate interaction involving the Companies?**

**A.** Yes. As part of the Commission review of the Peoples Gas' FY2001 gas costs in Docket No. 01-0707, the Commission found that that Peoples Gas inappropriately interacted with its affiliate, enovate, in such a manner that



increased gas costs to PGA customers while funneling profits to the affiliate.

As part of a settlement in Docket No. 01-0707, Peoples Gas agreed, among

other things, to provide a \$100 million reimbursement to ratepayers. The

Peoples Gas Light and Coke Co., ICC Final Order Docket No. 01-0707, 144

(March 18, 2006) ("2001 Reconciliation Case"). Staff has no desire to re-

litigate this case; however, there are parallels with other issues presented

here and this information is to provide the Commission with some context.

**Q. Did the Commission summarize Peoples Gas' interactions with enovate?**

A. Yes. The Commission found that enovate was an affiliated interest, as defined by the Act. The Commission stated:

Enron NA and PERC each formed a subsidiary for the purpose of owning interest in another limited liability company. Enron NA formed Enron Midwest, LLC ("Enron Midwest" or "Enron MW"); PERC formed Peoples Midwest, LLC ("Peoples Midwest"). (Staff Ex. 7.00 at 8). These two entities then formed enovate, LLC to facilitate a profit-sharing arrangement that gave PEC/PERC 50% of all of the profits Enron Midwest gleaned through various business dealings with PGL.

When Enron Midwest transacted business with PGL during the time period in question, 50% of Enron Midwest's profits were credited to enovate. Thus PEC/PERC received that 50% of Enron Midwest's profits. (Staff Ex. 9.00 at 15-16; 7.00 at 11). Enron Midwest was the managing partner of enovate because it possessed the skills, resources and expertise to operate enovate efficiently and profitably. (Tr. 812-13).

2001 Reconciliation Case Final Order at 15.

875 **Q. Did the Commission find Peoples Gas' interactions with enovate**  
 876 **violated the Act?**

877 A. Yes. The Commission found Peoples Gas and enovate interacted outside  
 878 an agreement approved by the Commission. PGL filed for Commission  
 879 permission to enter into a contract with enovate on November 28, 2000 in  
 880 Docket No. 00-0760, but then filed a Motion to Dismiss that proceeding on  
 881 March 21, 2001, which was granted. 2001 Reconciliation Case Final Order  
 882 at 16.

883

884 However, PGL continued to directly transact business with  
 885 enovate. PGL also transacted business with enovate indirectly,  
 886 through Enron NA/Enron Midwest. At no time did the  
 887 Commission approve any affiliate interest agreement between  
 888 PGL and enovate.

889

890 ...  
 891 enovate further conducted other transactions with PGL through  
 892 Enron Midwest. To reiterate, none of enovate's transactions  
 893 with PGL were made with Commission approval of an affiliated  
 894 interest contract.

894

895 Id. (emphasis added).  
 896

897 **Q. Did the Commission find that Peoples Gas acted improperly with**  
 898 **enovate?**

899 A. Yes. The Commission determined that Peoples Gas interacted with its  
 900 affiliate, enovate, improperly resulting in imprudent and unreasonable gas  
 901 charges:

902 Peoples Gas Light and Coke Company had not acted  
 903 reasonably and prudently in its purchases of natural gas and  
 904 other activities that affected that amounts collected through Gas  
 905 Charges in its fiscal year 2001;

906 . . .  
907 pursuant to the Settlement Agreement and Addendum, a refund  
908 of \$100 million is to be distributed in the manner set forth above  
909 as part of the consideration paid in global settlement of this  
910 docket, as well as I.C.C. Docket Nos. 01-0706, 02-0726, 02-  
911 0727, 03-0704, 03-0705, 04-0682, 04-0683.

912  
913 Id. at 144.  
914  
915

916 **Q. Do you think that Peoples Gas' interactions with enovate are relevant**  
917 **to this case?**

918 A. Yes. Peoples Gas misled the Commission regarding its interactions with  
919 enovate. In its previous Petition to the Commission, Peoples Gas asserted  
920 that its interactions with enovate would be proper:

921 9. All transactions with enovate would be at arms length.  
922 Peoples would keep records of all transactions for regulatory  
923 review.

924 10. The Master Contract will not interfere with Peoples'  
925 operation of its public utility business or with the performance of  
926 its duties to the public. Moreover, the Master Contract will allow  
927 Peoples to optimize its gas supply and capacity assets.  
928 Transactions which optimize Company assets will result in a  
929 positive revenue stream that will either be automatically flowed  
930 to customers through the operation of the Company's Rider 2,  
931 Gas Charge, or will operate to recover fixed costs.

932 11. The Master Contract is in the best interests of Peoples and  
933 the customers it serves. Accordingly, this Petition should be  
934 reasonably granted, and the public will be inconvenienced  
935 thereby.

936  
937 The Peoples Gas Light and Coke Co., ICC Docket No. 00-0760,  
938 Petition at 3 (emphasis added).  
939

940 **Q. Were the actions with enovate at arm's length?**

941 A. No. Despite its assertion that all interactions were to be at “arm’s length,”  
942 the Commission found that Peoples Gas treated enovate and its affiliates  
943 with preferential treatment.

944

945 **B. Questionable interactions with CNG affiliates by Peoples Gas.**

946 **Q. In addition to these cases where the Commission has already found**  
947 **against the Companies, are there any other instances where Peoples**  
948 **Gas has interacted with its affiliates which the Commission has not**  
949 **been made aware?**

950 A. In addition to these two instances of improprieties with PEHS and enovate,  
951 which have resulted in Commission action, Peoples Gas has twice interacted  
952 with two Compressed Natural Gas (“CNG”) affiliates completely outside the  
953 Commission-approved AIAs.

954

955 **1. Peoples Gas and Pinnacle**

956 **Q. How did Staff become aware of the Companies interactions between**  
957 **the Companies and Pinnacle?**

958 A. The Companies filed a petition to allow them to enter into an AIA with its  
959 affiliate Integrys Transportation Fuels (“ITF”) in Docket No. 12-0299.<sup>24</sup> In

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<sup>24</sup> Integrys created its subsidiary, ITF, “in August 2011 to invest in transportation fuel business opportunities.” The Companies report that Integrys “acquired two CNG infrastructure businesses, one comprised of Trillium USA Company and Trillium USA, LLC and the other comprised of Pinnacle CNG Company and Pinnacle CNG Systems, LLC.” (NS-PGL Ex. 1.0, 3, Docket No. 12-0299.) These companies became subsidiaries of ITF. Thus, the Companies are affiliates of ITF and its subsidiaries, including Pinnacle. (Companies Response to DR Docket No. 12-0299 RWB 1.07.)

that case the Companies indicated that Peoples Gas and Pinnacle, an ITF subsidiary, were currently interacting apart from any Commission approval to have Pinnacle build a CNG station on its Division Street facility. The proposed AIA would have allowed the Companies to sell any CNG station to ITF without direct Commission pre-approval.

**Q. How did you respond to the ITF AIA in that case?**

A. I recommended that the Commission not approve the ITF AIA, because it was not in the public interest to give greater freedom to interact with ITF. After I filed my direct testimony in that case, the Companies withdrew their Petition.

**Q. How did the Companies characterize the nature of the relationship between the Companies and Pinnacle in Docket No. 12-0299?**

A. During that case, Ms. Renier claimed that Pinnacle and Peoples Gas “entered into an agreement prior to Integrys’ acquisition of Pinnacle and the other transportation fuels companies, *i.e.*, prior to Pinnacle becoming an affiliate of Peoples Gas.” She also claimed that “Pinnacle and Peoples Gas are currently performing under this arm’s length agreement.” Docket No. 12-0299 NS-PGL Ex. 1.0, 3-4 (emphasis added). Furthermore, Mr. Wyrick also emphasized that, “this agreement pre-dated Pinnacle’s affiliation with Peoples Gas.” Docket No. 12-0299 NS-PGL Ex. 2.0, 3.

**Q. Do you agree with the characterization of the contract between Pinnacle and Peoples was an “arm’s length agreement”?**

A. No. A series of events in 2011 and several internal Company documents<sup>25</sup> listed below cause me to doubt the claims that the Peoples Gas-Pinnacle contract was arm’s length. Also, as shown above, the Peoples Gas made the same claim when it proposed to interact with its affiliate enovate.

**Q. Please describe the series of events in 2011 that cause you to disagree with the “arm’s length” characterization.**

A. Integrys, the holding company of Peoples Gas, entered into non-disclosure agreements (“NDA”) on May 18, 2011 with Pinnacle and Trillium, another company involved in CNG filing stations, in preparation for a merger. (Attach. J, Companies Response to DR Docket No. 12-0299 DAS 1.01(c).) On May 25, 2011, Peoples Gas terminated its CNG Station construction negotiations with Clean Energy. (Attach. K, Attachment D4.3.10b to Companies Response to Staff DR DAS-24.02(a).) On June 9, 2011, Peoples sent an RFP for services for a CNG filing station to Pinnacle, Trillium, and a third independent company, Dual Fuel Systems. (Attach. J, Attachment 1 to Companies Response to DR Docket No. 12-0299 DAS 1.01(e).) Pinnacle and Peoples Gas signed a contract for the construction of the CNG filing station on August 30, 2011. (Attach. J, Docket No. 12-0299

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<sup>25</sup> These documents are attachments to the Companies Responses to DAS-10.12(i), 20.01(a), 23.03(c) and 26.04.

Companies Response to DR DAS 1.01(a.) Two days later, on September 1, 2011, Integrys acquired Pinnacle and Trillium. (Attach. J, Companies Response to DR Docket No. 12-0299 DAS 1.01(b).)

**Table 5 – Timeline of the Peoples Gas - Pinnacle Issue**

Date	Event
May 13, 2009	Peoples Gas submits pre-approval request to GTI
May 18, 2011	Integrys entered into non-disclosure agreements with Pinnacle and Trillium
May 25, 2011	Peoples Gas terminates its CNG station construction negotiations with Clean Energy
June 3, 2011	Integrys entered into a Mutual Confidentiality Agreement with Pinnacle
June 9, 2011	Peoples sent an RFP for services for the construction of the CNG filling station
August 30, 2011	Pinnacle and Peoples Gas signed a contract for the construction of the CNG filling station
September 1, 2011	Integrys acquired Pinnacle and Trillium
September 13, 2011	Schedule of Work from Pinnacle received by Peoples Gas
September 21, 2011	Peoples Gas and GTI enter into grant agreement
November 22, 2011	CNG Station construction begins
November 23, 2011	Peoples Gas requests 60-day extension
December 20, 2011	GTI imposed in-service deadline

April 6, 2012	CNG Station operation begins
September 14, 2012	Peoples Gas received \$163,000 credit from Pinnacle
December 18, 2012	Peoples Gas ask for full rate base amount

1008

1009 **Q. Please describe your understanding of the evolution of the**  
1010 **relationship between Peoples Gas and Pinnacle.**

1011 A I see three distinct periods in the relationship between Peoples Gas and  
1012 Pinnacle. First, there is the period of time before Integrys entered into  
1013 negotiation to acquire Pinnacle and Trillium in which these firms were  
1014 unrelated. The second period was during those negotiations in which these  
1015 firms were what I would label as “pending-affiliates.” The final (and current)  
1016 period is the period as affiliates since the acquisition was complete.

1017

1018 **Q. What is it about this chain of events that causes you to reject the**  
1019 **“arm’s length agreement” claim?**

1020 A. Peoples Gas entered into a contract with a company that its parent  
1021 company would acquire within just two days. All the negotiations with  
1022 Pinnacle regarding the Pinnacle Agreement were completed after the NDA  
1023 was signed – after Pinnacle and Peoples Gas were “pending affiliates.” In  
1024 my opinion, it is not plausible that the pending affiliation had no effect on the  
1025 timing and process of selecting Pinnacle to construct the CNG station.  
1026 Additionally, all work performed by Pinnacle, all payments made by Peoples  
1027 Gas and all change order approvals were made after the two firms were



affiliates. Finally, as outlined below, several Peoples Gas internal documents reveal that there was affiliation influence on the interactions between Peoples Gas and Pinnacle both before and after they became affiliates.

**Q. Was there any benefit to Integrys as a result of the timing of the execution of the agreement between Peoples Gas and Pinnacle prior to the finalization of the merger with Pinnacle?**

A. Yes. If the merger was finalized first, then under the Act, the Peoples Gas–Pinnacle contract would have required either Commission approval for such an agreement or provision of the services at cost to Pinnacle under the STA. 220 ILCS 5/7-101(3).

**Q. Has the service contract for the CNG filling station been at issue in any other cases before the Commission?**

A. Yes. In the Companies 2012 Rate Case, Peoples Gas attempted to add the CNG station to its rate base. Staff witness Seagle and I objected, arguing that the costs had not been prudently incurred. See Staff Exs. 6.0, 31-36; 16.0, 13; 21.0 ibid., The Peoples Gas Light and Coke Co. and North Shore Gas Co., ICC Docket Nos. 12-0512/0511 (Cons.) (“2012 Rate Case”). Peoples Gas eventually withdrew the CNG station from its rate base proposal. See Companies Ex. 44.0, 2, 2012 Rate Case. Much of the evidence Staff presented in that case is relevant here because it shows that

1051 Peoples Gas favored its then-pending affiliate, Pinnacle, in its Request for  
1052 Proposals (“RFP”) process, as I will discuss further below.

1053

1054 **Q. Do you have other concerns about the contracting process followed**  
1055 **for the CNG fueling station contract?**

1056 A. Yes. The RFP process appears to have been conducted in a manner to  
1057 favor Pinnacle. The RFP was narrowly circulated to two of the Companies’  
1058 “pending affiliates” (one of which did not respond to the RFP) and one  
1059 independent firm, Dual Fuels Systems. Dual Fuels Systems did not  
1060 normally perform one of the services required in the RFP, and its lack of  
1061 response concerning that service resulted in the bid’s rejection. In addition,  
1062 the response period allowed was quite short, which could have contributed  
1063 to the incomplete response by the independent bidder.

1064

1065 **Q. Did Peoples Gas allow sufficient time for the RFP response?**

1066 A. No. Peoples Gas set the RFP response date for June 22, 2011, which  
1067 allowed 13 days for the RFP response. (Attach. J, Attachment to  
1068 Companies Response Staff DR DAS-1.01(e).) Pinnacle submitted its bid  
1069 on Friday, June 24, 2011. Dual Fuel Systems submitted its bid on Monday,  
1070 June 27, 2011. (Companies Response to Staff DR Docket No. 12-0299  
1071 DAS-2.01.)

1072

1073 **Q. Has Peoples Gas defended the legitimacy of the contract bidding**

|

1074 **process?**

1075 A. Yes. In the 2012 Rate Case, Peoples Gas witness Mr. Hoops stated that,  
1076 “[t]his project was competitively bid and bids were received from two vendors.”  
1077 See NS-PGL Ex. 28.0, 11, 2012 Rate Case. Peoples Gas maintained that its  
1078 interactions with Pinnacle before its acquisition were at arms-length. “[T]he  
1079 construction agreement was entered into by two unrelated, unaffiliated  
1080 companies under an arms-length agreement.” (Companies Response to Staff  
1081 DR DAS-9.02(c), 2012 Rate Case.)

1082

1083 **Q. How do you respond to Mr. Hoops’ statement?**

1084 A. The fact that Peoples ultimately received two bids, only one of which was  
1085 complete, does not show that the RFP was competitive. On the contrary,  
1086 the fact that Peoples Gas only received two bids is consistent with the  
1087 process not being competitive.

1088

1089 **Q. How else did Mr. Hoops defend the solicitation process?**

1090 A. Mr. Hoops claimed “Peoples Gas followed all business processes as with  
1091 any other project in bidding for this project.” (NS-PGL Ex. 28.0, 11, 2012  
1092 Rate Case.)

1093

1094 **Q. What is your response to this claim?**

1095 A. This statement was misleading because it suggests that People Gas followed  
1096 a set procedure for developing the list of recipients for its RFPs – also known

as a “bid list.” However, Peoples Gas admitted that “[t]here are no documented procedural steps used during the creation of the bid list.” (Peoples Gas’ response to Companies Response to Staff DR DAS 8.02(a), 2012 Rate Case.) Furthermore, an internal audit Summary Memo found that there were inconsistencies between the standard practices and what actually occurred. (Attach. L, Attachment to the Companies Response to Staff DR DAS-20.01(f).) This Summary Memo concluded that there needed to be re-training because Peoples Gas did not follow procedures. Id. However, Peoples Gas cannot have “followed standard business practices” and failed to include Supply Chain services early in the process which resulted in “appropriate procurement policies...not being utilized.” Id.

**Q. How did Peoples Gas determine the list of recipients for its RFPs?**

A. Peoples Gas provided a “bid list” of firms to IBS Supply Chain Services<sup>26</sup> to send the RFP. However, for the CNG station RFP process, that bid list included only three firms. (Peoples Gas’ Response to DR DAS-8.02, 2012 Rate Case.) The bid list was compiled by a group of four individuals; the group never considered any additional firms. It also did not conduct an internet search to find other qualified firms. (Peoples Gas Response to DR DAS-11.01, 2012 Rate Case.) Rather, Peoples Gas used only three firms with which it had prior involvement and two of which it was acquiring.

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<sup>26</sup> IBS Supply Chain Services is a division within IBS that handles procurement.

1119 **Q. How does Peoples Gas attempt to justify that its bid list selection**  
 1120 **process was fair?**

1121 A. Peoples Gas insists that the people on the bid list group did not know about  
 1122 the acquisition. (Attach. M, Companies Response to Staff DR DAS-  
 1123 14.09(c).)

1124 **Q. How do you respond to this claim by Peoples Gas?**

1125 A. I disagree with it. While Companies also insisted that the RFP process was  
 1126 competitive (Peoples Gas Ex. 28.0, 11, 2012 Rate Case) and followed  
 1127 standard business processes (Companies Response to DR ENG-6.05, 2012  
 1128 Rate Case), I have learned that the senior member of the bid list development  
 1129 group was Mr. Calvin (Peoples Gas' Response to DR DAS-8.02, 2012 Rate  
 1130 Case.), a vice president who was privy to the acquisition information (Attach.  
 1131 N, Revised Attachment 1 to the Companies Supplemental Response to Staff  
 1132 DR DAS-10.19). Mr. Calvin approved the bid list. (Attach. O, DAS-15.02(d).)  
 1133 Notably, Mr. Calvin also became an employee of ITF and an officer of the  
 1134 winning firm (Companies Response to Staff DR DAS-8.02, 2012 Rate Case.)  
 1135 BEGIN CONF. \*\*\* XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX his new  
 1136 employer. \*\*\* END CONF (CONFIDENTIAL Attach. P, Companies  
 1137 Confidential Response to Staff DR DAS-10.18.)

1138  
 1139 **Q. How else does Peoples Gas attempt to justify that its interaction with**  
 1140 **Pinnacle was not preferential to Pinnacle relative to DFS?**

1141 A. Peoples Gas insists that the construction contract approval group were not  
1142 aware of nor influenced by the acquisition. (Attach. Q, Companies  
1143 Response to Staff DR Docket No. 12-0299 DAS-7.02(f), ~~2012 Rate Case.~~)  
1144

1145 **Q. How do you respond to this claim by Peoples Gas?**

1146 A. Integrys Audit Services conducted an audit that specifically looked at the  
1147 interactions between Pinnacle and Peoples Gas regarding the CNG station  
1148 construction contract. This audit evaluated whether there was any  
1149 preferential treatment in the RFP selection process and concluded that  
1150 there was no preferential treatment. (Attach. R, Attachment to the  
1151 Companies Response to Staff DR DAS-23.03(c), 2.)  
1152

1153 **Q. How do you respond to this audits conclusion?**

1154 A. Despite the finding in the audit report of many inconsistencies between  
1155 standard practice and this particular RFP selection process, the report  
1156 included only one reason why there was no preferential treatment, but  
1157 included three reasons to suggest preferential treatment in the selection  
1158 process. (Attach. R, Attachment to the Companies Response to Staff DR  
1159 DAS-23.03(c), 2-3.) The sole basis provided for the finding of no  
1160 preferential treatment was that all employees interviewed, save one Mr.  
1161 Walsh, “asserted no knowledge of the plans to acquire Pinnacle.” This audit  
1162 listed Mr. Calvin as one of those interviewed. (Attach. R, Attachment to the  
1163 Companies Response to Staff DR DAS-23.03(c), 2-3.) The Companies now

acknowledge, however, that Mr. Calvin, who approved the bid list (Attach. O, Companies Response to Staff DR DAS-15.02(d)), was also on the acquisition access list (Attach. S, Companies Response to Staff DR DAS-10.19) and Mr. Calvin had knowledge at the time. (Attach. T, Companies supplemental response to Staff DR DAS-18.01, p. 9) Thus, the conclusion of the report – that there was no preferential treatment - was based on information that was entirely incorrect.

**Q. What evidence in the report is inconsistent with the conclusion that there was no preferential treatment?**

A. The audit report makes note of several instances where Pinnacle was given preferential treatment. The audit makes the following statements:

- “Cost analysis did not reflect the \$100,000 (later changed to \$88,000 in Pinnacle’s revised proposal) proposed by Pinnacle for security work. The cost analysis used the competing bidder’s amount of \$36,500 [for security work].” (Attach. R, Attachment to the Companies Response to Staff DR DAS-23.03(c), 2-3.) The effect of performing the cost analysis in this manner made Pinnacle’s bid appear less costly than it really was. Pinnacle was paid the full price after the contract was won.
- “Pinnacle’s proposal amount was adjusted upwards to reflect the pricing of the competing bidder where Pinnacle did not (could not) include an amount for specific line items. After Pinnacle’s amount

was adjusted upward, it exceeded the competing bidder's proposal amount." (Attach. R, Attachment to the Companies Response to Staff DR DAS-23.03(c), 2-3.) Thus, Pinnacle was not the cheapest bid, yet it won the contract.

- "There is no documentation to support that the competing bidder was allowed to counter." (Attach. R, Attachment to the Companies Response to Staff DR DAS-23.03(c), 2-3.) Thus, Dual Fuels System appeared to be at a disadvantage here because it was not allowed to make a counter offer.

**Q. What other evidence did you find that shows that Pinnacle received preferential treatment from Peoples Gas and IBS?**

A. IBS entered into a Mutual Confidentiality Agreement ("MCA") with Pinnacle as part of this RFP process. This MCA became part of the construction contract between Pinnacle and Peoples Gas. However, the MCA was not signed on August 30, 2011 with the rest of the construction contract. Rather, it was signed on June 3, 2011 before the RFP was sent out. (Confidential Attach. U, Companies Response to Staff DR Docket No. 12-0299 RWB-1.03 and Confidential Attachment 4) Furthermore, neither Peoples Gas nor IBS entered into any MCA with Trillium or Dual Fuel Systems. (Companies Responses to Staff DRs DAS-25.02, DAS-27.01.) This indicates a preference for Pinnacle before the RFP was even sent out.



|

1210 **Q. You indicate that one vendor did not provide a complete bid. Would**  
1211 **you elaborate on this point?**

1212 A. Yes. Dual Fuel Systems, the independent vendor, did not provide a bid on  
1213 the operation and maintenance for the facility, which the RFP required. (NS-  
1214 PGL Ex. 28.0 Rev., 11, 2012 Rate Case.) The RFP required a proposal for  
1215 operations and maintenance support, including all planned and unplanned  
1216 maintenance and repair, 24-hour monitoring and fault detection, and the  
1217 ability to remotely assist fueling customers. (Peoples Gas' Response to DR  
1218 2012 Rate Case DAS-11.01, Attachment 1, 14-15.) On January 15, 2013,  
1219 Mr. Eric Schwab, the CEO and General Manager of Dual Fuels Systems,  
1220 indicated in a telephone conversation with me that Dual Fuels Systems  
1221 does not provide 24-hour monitoring and fault detection or the ability to  
1222 remotely assist fueling customers.

1223

1224 **Q. Was there a need to include operations and support services in the**  
1225 **RFP?**

1226 A. I do not believe there was a legitimate need. Peoples Gas could have had  
1227 a separate RFP process for the operation and maintenance of its station,  
1228 allowing additional entities to submit bids for other aspects of the RFP. My  
1229 belief is supported by the fact that the winning bidder, Pinnacle, never  
1230 operated the station, therefore, there was no legitimate reason to disqualify  
1231 Dual Fuel Systems from consideration for not providing a bid for a part of  
1232 the RFP that the winning bidder was never called on to perform.

1233 Additionally, Pinnacle also provided a bid that was incomplete in that it did  
1234 not provide cost estimates for all listed services. (Attach. V, Peoples Gas'  
1235 Response to DR DAS-11.04, Attachment 01, 2012 Rate Case.) As Peoples  
1236 Gas witness Mr. Wyrick indicated, "[t]he agreement [for which there was the  
1237 RFP was] for the construction of a fueling station. The agreement covered  
1238 the construction of the station only and not operations." NS-PGL Ex. 2.0,  
1239 3, Docket No. 12-0299.) ITF now operates the station. (Companies'  
1240 response to DR Docket No. 12-0299 DAS-1.02.)

1241  
1242 **Q. What other factors may have influenced the selection of the bid?**

1243 A. An internal document regarding the RFP Award Analysis Procedures of IBS  
1244 Supply Chain Services, which conducts the RFP process, states that  
1245 BEGIN CONF. \*\*\* XX  
1246 XX  
1247 XX  
1248 XXXXXXXXXXXXX\*\*\* END CONF (Confidential Attach. W, Peoples Gas'  
1249 Response to DR DAS-10.01, Confidential Attachment 04, 1-2, 2012 Rate  
1250 Case (emphasis added).) BEGIN CONF \*\*\*XXXXXXXXXXXXXXXXXXXXX  
1251 XX  
1252 XX  
1253 XXXXXXXXXXXXX \*\*\* END CONF

1255 **Q. Were there any other factors that may have influenced the RFP**  
1256 **process?**

1257 A. Yes. Peoples Gas pursued and received a grant from the City of Chicago  
1258 ("City") to build the CNG station. In May 2009, Peoples Gas submitted for  
1259 pre-approval of its grant with the City. At that time, Peoples Gas estimated  
1260 that the cost of the station would be \$692,400, and it asked for funding of  
1261 the entire amount. (Peoples Gas' Response to Staff DR DAS-7.01,  
1262 Attachment 01, 4, 2012 Rate Case.) Peoples Gas eventually signed a grant  
1263 agreement that dictated the terms and conditions under which the grant  
1264 funds would be provided to Peoples Gas. (Peoples Gas' Response to DR  
1265 ENG-6.02 Attachment 01, 2012 Rate Case.) The fact that Peoples Gas  
1266 thought it would get the station without spending any of its own money may  
1267 have induced it to move ahead. However, its initial estimate was severely  
1268 understated. The total project costs rose to \$1,550,092.<sup>27</sup>

1270 **Q. Did Peoples Gas have a compressed time-line that would preclude a**  
1271 **second, longer RFP process or a second RFP with a broader**  
1272 **dispersion once it received only one complete bid?**

1273 A. No. The stated project completion date was December 20, 2011. (Attach.  
1274 J, Attachment to Companies Response to Staff DR Docket No. 12-0299  
1275 DAS-1.01(e), 1.) However, when Peoples Gas entered into the contract

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<sup>27</sup> Rate base amount \$857,692 plus grant amount \$692,400. (Peoples Gas Response to Staff DR DAS-6.02(f) 2012 Rate Case.)

with Gas Technology Institute (“GTI”), it had already received a progress schedule from Pinnacle that reflected that the station would not be operational until late January. (Attach. X, Companies Response Staff DR DAS-25.02(a).) Thus, Peoples Gas knew that it would not be able to fulfill this obligation. Additionally, construction on the CNG station did not begin until November 22, 2011. (Companies Response to DR Docket No. 12-0299 DAS-1.01(f).) The station was not functionally operational until April, 6 2012. (Companies’ Response to DR Docket No. 12-0299 RWB-1.05(c).) Furthermore, Peoples Gas states that: “[t]he station construction RFP date was set by the project group with the goal of meeting or exceeding the in service requirements set forth in the grant agreement. The grant agreement did not preclude the requirement of any selected vendor to meet an earlier work completion date.” (Peoples Gas Response to DR DAS-7.02, 2012 Rate Case.) On November 23, 2011 Peoples Gas proposed to GTI to extend the deadline by 60 days, indicating that it had been in discussions with GTI and found GTI open to such an extension. (Attach. Y, Companies Response to Staff DR DAS-26.02 and Attachment.) This extension was not formally accepted (Attach. Y, Companies Response to Staff DR DAS-26.02(b)), but Peoples Gas was never penalized by GTI for not completing the station before December 20, 2011 (Companies Response Staff DR DAS-22.01(g)). It is worth noting that Peoples Gas had been considering this project for more than two years before it sent out its RFP. There was ample time for it to find other qualified firms. The compressed RFP timeline

could have been influenced and rushed by the impending acquisition of Pinnacle and the additional affiliate contracting requirements that affiliation would cause.

**Q. What do you conclude about the RFP process?**

A. Competitive pressures on Pinnacle were removed by sending the RFPs to two pending affiliates and only one independent company that did not provide all the “required” services. Peoples Gas failed to conduct any research to find any other possible firms outside of those already known to it. A good faith effort to have a competitive RFP process would have required a broader solicitation with more time to respond.

**Q. Could the affiliate status of Pinnacle affect its bid and subsequent selection by Peoples Gas?**

A. Yes. It would be reasonable for Pinnacle to have had an expectation that when it submitted its bid, it would be an affiliate of Peoples Gas before it began construction, which, in fact, is precisely what occurred. Therefore, Pinnacle may have been able to offer a lower bid with some expectation that, despite language in the contract indicating the bidder would be responsible for cost over-runs, Peoples Gas might not hold it responsible for cost over-runs or other financial penalties that might arise. The initial bid submitted by Pinnacle was \$888,775. (Companies Response to DR Docket No. 12-0299 DAS-1.01(g).) The total amount that Peoples Gas paid

to Pinnacle was \$1,375,208.95. (Attach. Z, Attachment 1 to Companies Response to Staff DR DAS-22.02. Thus, the amount paid to Pinnacle rose more than 54% above the price of the bid. Peoples Gas proposed in its rate case to include the increase in the amount paid to Pinnacle in rate base in that proceeding, with no cost overruns absorbed by Pinnacle. Also, when it selected its “pending affiliate” Pinnacle as the winning bidder, Peoples Gas was reasonably certain that Pinnacle would be an affiliate *before any work commenced*. Indeed, affiliation occurred two days after the contract was signed.

**Q. What did the Companies state regarding the connection of the Construction contract process and the acquisition of Pinnacle?**

A. The Companies insist that there was no rush to get the contract approved before the acquisition was executed. (Attach. AAQ, Companies Response to Staff DR Docket No. 12-0299 DAS-7.02(g).) They also insist that neither they nor their affiliates expedited the approval of this contract to allow the acquisition to occur.<sup>28</sup> (Attach. AB, Companies Supplemental Response to Staff DR DAS-18.03(a).)

**Q. Were the two processes connected?**

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<sup>28</sup> Rather, they claim that “Efforts to complete the RFP process were in response to the upcoming deadline set forth in the grant agreement. (Companies Response to Staff DR DAS-18.03(a).) However, the grant agreement between GTI and Peoples Gas was not even signed and the deadline on the grant agreement between the City and GTI was for 21 Dec 2012, more than 15 months distant.

1342 A. Yes. The Project Change Request along with the attached email string brings  
1343 the involvement of Mark Radtke into focus. Mr. Radtke was the project  
1344 sponsor, and authorized the payment of the change order requested by  
1345 Pinnacle through Jeff Krueger, one of the co-project managers along with Mr.  
1346 Wyrick. (Attach. AC, Attachment 2 to the third supplemental response to Staff  
1347 DR DAS-10.12) This form included the description of the project and the  
1348 Change Orders to be approved. "This project was for EPC services from  
1349 Pinnacle CNG to Peoples Gas for the installation of a CNG filling station.  
1350 During the course of contract negotiations, several scoped line items were un-  
1351 priced by Pinnacle. In an effort to expedite the purchase of Pinnacle CNG by  
1352 Integrays Energy Group, a final price was not determined for un-priced line  
1353 items, instead an "allowance" was made for the unpriced line items. Id.  
1354 (emphasis added). Mr. Radtke approved this Project Change Request after  
1355 stating "we [PGL] were not disputing the legitimacy of the charges, even  
1356 though we did not anticipate they would be so large." Thus, the acquisition  
1357 process was not only connected to the construction project, the acquisition  
1358 was dependent upon the construction process approval and there was  
1359 pressure to get the construction project approved rapidly so that the  
1360 acquisition could go through. The award group, which included Mr. Radtke,  
1361 the project sponsor, and Mr. Krueger, one of the project managers, knew that  
1362 the two processes were linked. (Attach AD, Attachment to Companies  
1363 Response Staff DR DAS-26.04.)

1365 **Q. What did the Companies state regarding Mr. Radtke's and Mr.**  
1366 **Krueger's foreknowledge of the acquisition?**

1367 A. The Companies stated that Mr. Radtke "was not involved in the station  
1368 transaction negotiations with Pinnacle although he was involved in prior  
1369 matters related to the grant and prior contract matters associated with the  
1370 station. These events, and his awareness of the events that led to the CNG  
1371 station at Division Street, occurred in 2010 and 2011. He does not recall  
1372 specific dates when he became aware of the contract award to Pinnacle."  
1373 They also state that Mr. Krueger "became aware of the acquisition when it  
1374 was announced (the company press release is dated September 1, 2011)."  
1375 (Attach. T, Companies Supplemental Response Staff DR DAS-18.01) As  
1376 the Project Change Request Form shows, both of these individuals knew  
1377 that the construction and acquisition processes were linked, that the  
1378 construction contract process has been expedited and that corners had  
1379 been cut to get the construction contract signed before acquisition. (Attach  
1380 AD, Attachment to Companies Response Staff DR DAS-26.04.)

1381  
1382 **Q. In the 2012 Rate Case, Mr. Hoops testified in part as follows regarding**  
1383 **the selection of Pinnacle as the winning bidder:**

1384 **This project was competitively bid and bids were received**  
1385 **from two vendors. However, the bid from one vendor was not**  
1386 **complete as it did not provide for the required operation and**  
1387 **maintenance support of the installed product. The other bid**  
1388 **was complete and was otherwise satisfactory. Therefore, the**  
1389 **selected vendor was based on the only complete bid. The fact**  
1390 **that the company that was selected, then became an affiliate,**  
1391 **does not change these facts**



**(NS-PGL Ex. 28.0 Rev, 11, 2012 Rate Case.) Do you have any comment with respect to enforcement of terms of the contract to include cost over-runs?**

A. Yes, The agreement between Peoples Gas and Pinnacle has been described as an “arms length agreement.” (NS-PGL Ex. 1.0, 3-4 Docket No. 12-0299.) However, I find this to be misleading on many fronts, including the enforcement of terms of the contract. Peoples Gas states:

[T]he construction agreement was entered into by two unrelated, unaffiliated companies under an arms-length agreement. The indemnification terms just like the other terms are not only standard for Peoples Gas but are also at least as protective to Peoples Gas as one would find elsewhere in the market. The terms of the agreement speak for themselves and are fully-enforceable by both parties just as they would be if the agreement had been entered into between Peoples Gas and an entity that became an affiliate five years after signing the agreement or if Peoples Gas had entered an agreement with another unaffiliated contractor that Peoples Gas considered for the work such as Dual Fuels.

(Peoples Gas’ Response to Staff DR 2012 Rate Case (emphasis added).)

All work performed under the contract was performed by Pinnacle while it was an affiliate with Peoples Gas. All payments to Pinnacle were made after it was an affiliate. (Attach. Z, Attachment 01 to the Companies Response to Staff DR DAS-22.02.) Any cost over-runs or change orders would have to be negotiated by both firms as affiliates. (Companies’ response to DR Docket No. 12-0299 DAS 1.04.) If the performing party had been the unaffiliated Dual Fuel Systems, then Peoples Gas would have had an economic incentive to not allow Dual Fuel Systems to pass along those

added costs to the Company. Because Pinnacle was already an unregulated affiliate, however, passing along additional costs and negotiating for change orders might allow the Utility to pass those costs on to ratepayers and shield Integrys its affiliate from such costs. I similarly testified that the affiliate relationship could lead to cost overruns in the 2012 rate case. (Staff Ex. 21.0, 23-24, 2012 Rate Case.)

**Q. What other evidence did you find about Peoples Gas' treatment of cost overruns?**

A. The change order approval email demonstrates that Peoples Gas approved all change orders at the exact price and contractor margin that Pinnacle requested. While the Companies insisted that the 15% contractor margin was a part of the contract (Attach. AC, Companies Third Supplemental Response to Staff DR DAS-10.12(ii)), the contract does not specify any margin and both Pinnacle and Peoples Gas were aware that no margin was specified, as evidenced by Pinnacle's mention of this fact to Peoples Gas in the change order request (Attach. AE, Attachment 1 to the Companies Response to Staff DR DAS-18.02). After review by Integrys accounting (which followed Staff's inquiry into this transaction), Pinnacle was forced to refund \$163,723 to Peoples Gas more than half of its cost overruns. (Attach. R, Attachment to Companies Response to Staff DR DAS-23.03(c).) Evidence shows that the cost over-runs were due in part to Pinnacle

1446 overcharges to Peoples Gas. (Attach. AF, Supplemental Companies  
1447 Response to Staff DR DAS-23.01c and Attachment)

1448

1449 **Q. Did Peoples Gas' notify the Commission or Staff of this refund?**

1450 A. Peoples Gas neither testified about nor alerted the Commission or Staff to  
1451 this adjustment in either the 2012 Rate Case or Docket No. 12-0299. Nor  
1452 did Peoples Gas adjust its proposed rate base addition down to reflect the  
1453 lower cost actually incurred (Attach. AG, Companies Response to Staff DR  
1454 DAS-21.04(e)), despite the fact that it received the refund on September 27,  
1455 2012. On the contrary, Peoples Gas still insisted that the full project amount  
1456 had been prudently incurred and attempted to (over-)recover more than the  
1457 full amount of the project. Taxpayers had already paid \$692,400 (received  
1458 in June 2012) and the Peoples Gas sought to recover \$857,692 from its  
1459 ratepayers for a total amount of \$1,550,092, despite the fact that Peoples  
1460 Gas knew before it filed rebuttal testimony on December 18, 2012 that it  
1461 had only spent \$1,408,021.83. Peoples Gas should have reduced its  
1462 proposed rate base amount by the amount of the credit and acknowledged  
1463 that it had overpaid Pinnacle.

1464

1465 **Q. How does the Companies' proposal to enter into an AIA with ITF in**  
1466 **Docket No. 12-0299 factor in here?**

1467 A. The Companies proposed to adopt an AIA with ITF in Docket No. 12-0299.  
1468 The only incremental service that would have been allowed under the ITF

AIA would have been for property transfers (sales). Peoples Gas could have transferred the Pinnacle CNG station to ITF after it was established and commercially viable without any Commission approval. Thus, it appears that the purpose all along with this station was for ITF to end up with the station, but only if it was in the shareholders best interests.

**Q. Even though the Companies withdrew their ITF AIA petition, is the issue of the sale of this station still relevant?**

A. Yes. The Master AIA which went into effect after the withdrawal of the Petition in Docket No. 12-0299 allows the Companies to sell property to their affiliates without subsequent Commission approval regardless of the amount. (Companies Response to Staff DR DAS-6.02a) Given that the timing of any such a transfer will certainly occur when optimum for the affiliate and the pricing of this transfer will be highly speculative, I do not think that this transfer would be in the public interest. Regardless, the Commission should review the precise details of any such property transfer and determine if the deal is reasonable.

**Q. What do you conclude from the evidence provided here concerning the record of actions by Peoples Gas in its relations with Pinnacle?**

A. Peoples Gas' actions reflect favoritism toward its affiliate Pinnacle at the expense of its customers and are not consistent with the public interest.

1492 **Q. Is there any other aspect of the Pinnacle acquisition that concerns**  
1493 **you?**

1494 A. Yes. The Companies did not notify the Commission when ITF was added  
1495 to the STA. The STA requires that the Companies notify the Commission  
1496 when adding a party to the STA. According to Paragraph 2. Notices to  
1497 Article X REGULATORY REQUIREMENTS of the STA:

1498 Peoples Gas and North Shore shall notify the Commission each  
1499 time a new Party becomes eligible to receive or provide  
1500 Services and Facilities or transfer or acquire assets under this  
1501 Agreement.

1502 a. This notice shall be by means of a letter to the following or  
1503 any successor to the following: Commission's Manager of  
1504 Accounting, Manager of the Energy Department, Public Utilities  
1505 Bureau Chief, the Executive Director and an informational filing  
1506 in the Commission docket in which this Agreement was  
1507 approved.

1508 b. Such notice shall include: (i) a description of the anticipated  
1509 transactions between Peoples Gas or North Shore and the new  
1510 Party; (ii) a revised organizational chart showing all Parties and  
1511 their subsidiaries; (iii) a list of the Board of Directors and officers  
1512 of the new Party; (iv) a statement of whether Peoples Gas and  
1513 North Shore expect the new Party to be a Providing Party,  
1514 Receiving Party Transferring Party or Acquiring Party; and (v) a  
1515 statement regarding the expected quantity of transactions that  
1516 Peoples Gas or North Shore expects to conduct with the new  
1517 Party.

1518  
1519 (Companies Response Staff DR DAS-1.01(a) Attachment 1,  
1520 10.)

1521  
1522 Thus, the Companies failure to notify the Commission was not in  
1523 compliance with the STA.

1524

1525 **Q. How is this lack of notice affecting the issue of Commission relevant**  
1526 **here?**

1527 A. The failure to provide notice is an example of the Companies failing to take  
1528 appropriate actions regarding their interactions with their affiliates. If the  
1529 Companies cannot follow the requirements of the AIA already in place, the  
1530 Commission should restrict them further.

1531

1532 **2. Peoples Gas and PNGV Corp.**

1533 **Q. Have you found other questionable interactions between Peoples Gas**  
1534 **and another of its CNG affiliates?**

1535 A. Yes. During the investigation into the facts surrounding the relationship  
1536 between Peoples Gas and Pinnacle, I found a reference to another CNG  
1537 station that pre-dated the current CNG station, this one “operated” by PNGV  
1538 Corp.. As I investigated further, I found evidence of disregard for the terms  
1539 of the AIA approved by the Commission.

1540

1541 **Q. Please give some background on the PNGV Corp. CNG station.**

1542 A. During 1995-1996, Peoples Gas built a CNG station on its Division Street  
1543 property for its affiliate PNGV Corp. to use. PNGV Corp. was added to the  
1544 ISA on January, 28, 1994. (Companies Response to Staff DR DAS-  
1545 14.05(e).) Since PNGV Corp. had no employees (Companies Response to  
1546 Staff DR Docket No. 12-0299 DAS-10.01(f)), Peoples Gas provided all  
1547 services needed to build and operate the station for PNGV Corp.  
1548 (Companies Revised Response to Staff DR Docket No. 12-0299 DAS-  
1549 11.04(c).) Peoples Gas constructed the station between December 1995

and June 1996 and spent more than \$479,000 on external costs for the construction. (Attach. AH, Companies Response to Staff DR DAS-16.01.) In addition, Peoples Gas incurred internal labor costs as well as permitting costs. (Companies Supplemental Responses to Staff DRs DAS-17.05(g), (h).) Peoples Gas provided service to PNGV Corp. from April 1996-September 16, 2003 under tariff S.C. No. 8 – Compressed Natural Gas Service. PNGV Corp. “operated the station” using Peoples Gas employees. (Companies Revised Response to Staff DR Docket No. 12-0299 DAS-11.04(c).)

**Q. In addition to the tariffed S.C. No. 8 service, were there any non-tariffed services Peoples Gas charge PNGV Corp. for?**

A. Yes. Peoples Gas charged PNGV Corp. monthly for financing<sup>29</sup> (Companies Response to Staff DR Docket No. 12-0299 DAS-10.02(t) (aka “Rent Expense” or “Rental Expense”), supplies (Attach. AI, Attachment to Companies Response to Staff DR Docket No. 12-0299 DAS-7.01(h) and property management<sup>30</sup> (Companies Response to Staff DR Docket No. 12-0299 DAS-10.01(a).)

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<sup>29</sup> Called “Rent Expense” by Peoples Gas. Attachment to Companies Response to Staff DR Docket No. 12-0299 DAS-7.01h

<sup>30</sup> Called “Labor Rebill” by Peoples Gas. Attachment to Companies Response to Staff DR Docket No. 12-0299 DAS-7.01h

1569 **Q. Under what authority did Peoples Gas provide these non-tariffed**  
1570 **services to PNGV Corp.?**

1571 A. Peoples Gas never entered into a specific agreement with PNGV Corp.  
1572 regarding this station. Rather, Peoples Gas provided these services under  
1573 the ISA which required that Peoples Gas recover from PNGV Corp. all  
1574 “Reasonable Costs,” defined as “that amount of money which will make the  
1575 requested party whole for all costs and expenses relating to the  
1576 performance of such acts.”<sup>31</sup> (Attachment to the Companies’ Corrected  
1577 Response to DR DAS- 7.01(k).)

1578 **Q. How did Peoples Gas disregard its Commission-approved**  
1579 **agreement?**

1581 A. Peoples Gas never recovered the reasonable costs from PNGV Corp.  
1582 Therefore, Peoples Gas subsidized PNGV Corp and violated this  
1583 Commission-approved agreement.

1584

1585 **Q. Was the “Rent Expense” that Peoples Gas billed PNGV Corp. actually**  
1586 **for Rent?**

1587 A. No. Peoples Gas indicated that “the yearly rental expense amount  
1588 represents only a return on investment for costs incurred by Peoples Gas

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<sup>31</sup> “The requested party shall charge the requesting party an amount equal to the reasonable cost of performing any of the acts requested and performed in the manner described in Paragraph 1 hereof. For purposes of this Agreement, the words “reasonable cost” shall mean that amount of money which will make the requested party whole for all costs and expenses relating to the performance of such acts.” (Companies’ Corrected Response to DR Docket No. 12-0299 DAS-7.01(k).)



for construction of the station.” (Peoples Gas Response to Staff DR Docket No. 12-0299 DAS-10.02.) In fact, Peoples Gas provided detailed information on what was included in the “Rent Expense” charge. (Attach. AJ, Attachment to Companies Response to Staff DR Docket No. 12-0299 DAS-9.02.) That information is provided in Table 6 – Peoples Gas’ Rent Expense Charges to PNGV Corp. set forth below:

**Table 6 – Peoples Gas’ Rent Expense Charges to PNGV Corp.**

Station Facilities and Installation	\$172,607.45
Islands and Paving	\$114,146.13
Sidewalk	\$3,000.00
Security	\$21,875.89
Total Charges	\$311,629.47
Rate of Return-Per Dkt. # 95-0032	12.9180%
Yearly Rental Expense	\$40,256.29
Monthly Rental Expense	\$3,354.69

All the inputs to the total charge are one-time, construction-related charges to which a rate of return is applied to determine the so-called “rental charge.” It’s a finance charge, and only on a portion of the capital costs that Peoples Gas used for PNGV Corp.’s benefit.

**Q. Was this expansion of its utility plant for the exclusive benefit of PNGV Corp. analogous to any other charges that Peoples Gas charges?**

1604 A. Yes. Peoples Gas expanded its utility plant for PNGV Corp. in a manner that  
1605 benefitted only PNGV Corp as Peoples Gas never used this facility for CNG  
1606 purposes. (Supplemental Response to Staff DR DAS-17.05) This is  
1607 analogous to main extensions, where the Utility expands its utility plant for the  
1608 exclusive benefit of a third party – prospective ratepayers. In that latter case,  
1609 Peoples Gas charges the third party up front for the maximum amount allowed  
1610 by the Commission’s Rules for main extensions.<sup>32</sup> (Attach. AH, Companies  
1611 Supplemental Response to Staff DR DAS-11.01(a).) This charge would  
1612 include costs associated with parts, labor, overhead, permits and loadings.  
1613 (Attach. AL, Companies Response to Staff DR DAS-15.03(i).) An affiliate  
1614 should not get a better deal than prospective ratepayers desiring to expand  
1615 utility plant for their own use.

1616  
1617 **Q. How was this expansion of its utility plant for the exclusive benefit of**  
1618 **PNGV Corp. different from main extensions that Peoples Gas performs**  
1619 **for prospective ratepayers?**

1620 A. In a main extension, the prospective ratepayer is required to provide the entire  
1621 amount of capital up front before the project begins. Here, Peoples Gas  
1622 provided the capital for PNGV Corp., essentially loaning PNGV Corp. the  
1623 entire amount needed to construct this station.

---

<sup>32</sup> There is a small amount of free extension either (100-200 feet). These charges are called deposits but are only refunded if another third party makes use of the new plant within 10 years; however, in the event of a refund, the utility is still made whole for all of its costs.

1624

1625 **Q. Did PNGV Corp. pay for the reasonable financing and construction**  
1626 **costs associated with the CNG station?**

1627 A. No. Peoples Gas never charged PNGV Corp. for a single penny of the  
1628 construction cost. The only charge that Peoples Gas charged PNGV Corp.  
1629 for the project was a discounted finance charge based on 65% (Attach. AJ,  
1630 Docket No. 12-0299 DAS-9.02(a)) of the over \$479,964.42 in external  
1631 construction costs (Attach. AH, Companies Response to Staff DR DAS-  
1632 16.01). PNGV Corp. paid this discounted finance charge but never had to pay  
1633 back the principal. Rather, it only paid the interest on a portion of the principle  
1634 for 7 years, from 1996 to 2003. (Attachment to the Companies Supplemental  
1635 Response to Staff DR Docket No. 12-0299 DAS-7.01(h.)

1636

1637 **Q. Did Peoples Gas recover its investment for the construction of the**  
1638 **station from PNGV Corp.?**

1639 A. No. By my conservative estimate, PNGV Corp. paid only \$278,439.27 in  
1640 rental expense to Peoples Gas between October 1996 and September  
1641 2003.<sup>33</sup> Thus, Peoples Gas spent more than \$311,629.47 in external costs  
1642 on this project, but never recovered any of those original construction costs  
1643 cost.

---

<sup>33</sup> To reach this total, I used the amount provided by Peoples Gas for the years which it had records (FYs 1997, 1999, 2001-2003) and used the same monthly rental expense (\$3354.69) for each month that was not provided (FY1998, 2000).

1644

1645 **Q. Did Peoples Gas protect itself from any risk that PNGV Corp. might go**  
1646 **out of business before it paid for the reasonable financing and**  
1647 **construction costs associated with the CNG station?**

1648 A. No. Remarkably, Peoples Gas never entered into any sub-agreement or  
1649 memorandum of understanding requiring that PNGV Corp. remain in business  
1650 for any length of time or to pay back the principal on the loan. This CNG  
1651 market was very risky as it was an unproven technology. Peoples Gas could  
1652 have protected itself and its customers by requiring PNGV to sign a lease of  
1653 sufficient term to protect itself from the failure of PNGV Corp.'s risky venture  
1654 and charged enough monthly to repay the amount of the principle. However,  
1655 Peoples Gas could produce no Memorandum of Understanding (Companies  
1656 Response to Staff DR DAS-10.02(e)) and either had no recourse to PNGV  
1657 Corp. assets or made no claim on them when PNGV Corp. ceased operations.  
1658 Such a favorable arrangement, with no risk for stranded capital investment for  
1659 the tenant when the nascent market did not develop, would not likely have  
1660 been offered to an unaffiliated party.

1661

1662 **Q. What is your opinion of the agreement, given that Peoples failed to**  
1663 **protect itself from this risk?**

1664 A. The arrangement between PNGV Corp. was inappropriate. Peoples Gas  
1665 never should have entered into this type of arrangement without holding its  
1666 affiliate responsible until all costs were recovered. As it turned out, PNGV

Corp. closed shop before Peoples Gas recovered the construction costs, much less a financing charge, for the CNG station. (Attach. AJ, Peoples Gas Response to Staff DR Docket No. 12-0299 DAS 9.02 and Companies Response to Staff DR Docket No. 12-0299 DAS 10.01.) PNGV Corp. left Peoples Gas with an asset that Peoples Gas had never used (Companies Supplemental Response to Staff DR DAS-17.05) nor was it ever able to “lease” the station again (Companies Response to Staff DR DAS- 10.02(g)). If Peoples Gas had provided \$311,000 to PNGV Corp. at the beginning of the project, and if PNGV Corp. had provided \$311,000 at the end of the 7 years, the finance charge would have been reasonable. However, PNGV Corp. took cash at the beginning and returned a valueless asset at the end. This is not a reasonable arrangement for Peoples Gas to enter into. It would not have made a similar arrangement with a non-affiliate.

**Q. When you say that this charge was a discounted finance charge, what do you mean?**

A. Peoples Gas calculated the finance charge based upon \$311,000 which was only a portion of its external costs. The total external costs without any permitting were \$479,000; adding in permitting for the project would have further increased costs. (Companies Supplemental Response to Staff DR DAS-17.05(h).) Additionally, Peoples Gas never included any of its labor and overhead costs associated with designing and managing the station construction. (Companies Supplemental Response to Staff DR DAS-

1690 17.05(g).) Thus, the finance charge was inadequate even to compensate for  
1691 the use of its capital for those 7 years.

1692

1693 **Q. Were there any other charges that Peoples Gas failed to charge PNGV**  
1694 **Corp.?**

1695 A. Yes. Peoples Gas never charged for compression of the natural gas that it  
1696 supplied during the 7 years that PNGV Corp. operated its CNG station.  
1697 (Companies Responses to Staff DRs DAS-14.07; 15.08.)

1698

1699 **Q. How did Peoples Gas explain the rate base addition of the facility?**

1700 A. When asked to explain “whether these costs were included in rate base by  
1701 Peoples Gas,” Peoples Gas responded that this “[d]etail is not available.”  
1702 (Peoples Gas’ response to DR Docket No. 12-0299 DAS 10.02(c).) Peoples  
1703 Gas also could not address whether it was added to rate base in Docket No.  
1704 95-0032, which had a future test year of beginning October 1, 1995. (Order,  
1705 Docket No. 95-0032, November 8, 1995.) The station appears to have been  
1706 constructed from December 1995 to June 1996. (Attach. AH, Attachment to  
1707 the Companies Response to Staff DR DAS-16.01) Thus, the station was  
1708 completed and in service prior to that test year being finished. (Attach. AI,  
1709 Companies Response to Staff DR Docket No. 12-0299 DAS-7.01(c).)  
1710 Furthermore, revenues from PNGV Corp. did not begin until October, 1996,  
1711 which was after the test year ended. (Attach. AI, Attachment to the  
1712 Companies Supplemental Response to Staff DR Docket No. 12-0299 DAS-

7.01(h).) Thus, it is quite possible that ratepayers paid for the station construction for the better part of 12 years but did not receive any benefit from the revenues paid by PNGV Corp. However, even if Peoples Gas ratepayers never paid for this station construction, it is not in the public interest for Peoples Gas to subsidize its affiliates.

**Q. Please summarize your conclusions regarding the evidence about the PNGV Corp. CNG station.**

A. Peoples Gas provided services for which it did not receive full, reasonable cost compensation. The interactions described above between Peoples Gas and PNGV support my conclusion that Peoples Gas acted contrary to the public interest.

**VI. Conclusion**

**Q. What do you conclude about the Companies interactions with their affiliates?**

A. The Companies have a history of abuses of the public interest that require the Commission to act to protect the public interest going forward. In particular, Peoples Gas has acted against the public interest as follows:

1. Peoples Gas provided services for PNGV Corp. under the Intercompany Service Agreement ("ISA") that was not provided at cost as required.

2. Peoples Gas interacted with Pinnacle preferentially before it became an affiliate.

- 1737 3. Peoples Gas interacted with Pinnacle after it became an affiliate  
1738 under an agreement that had not been approved by the Commission.
- 1739 4. Peoples Gas interacted with Pinnacle under the STA after it  
1740 became an affiliate but before it was properly added to the STA.
- 1741 5. Peoples Gas interacted with Integrys Transportation Fuels after  
1742 it became an affiliate but before it was properly added to the STA.
- 1743 6. Peoples Gas attempted to include in its rates costs for PPP  
1744 solicitation services provided by IBS at no charge to PEHS.
- 1745 7. Peoples Gas charged PEHS PPP billing charges below cost by  
1746 not increasing those charges when postage rates increased.
- 1747 8. Peoples Gas increased charges for repairs to customer-owned  
1748 piping to ratepayers more than double its costs and charged PEHS  
1749 PPP repairs charges at cost. This provided PEHS with a competitive  
1750 advantage by disadvantaging ratepayers.
- 1751 9. Peoples Gas discriminated against ratepayers who did not  
1752 purchase PPP in the provision of repairs to customer-owned piping by  
1753 providing firm repairs services to PEHS but not ratepayers without  
1754 PPP.

1755

1756 Similarly, North Shore has acted against the public interest as follows:

- 1757 1. North Shore attempted to include in its rates costs for PPP  
1758 solicitation services provided by IBS at no charge to PEHS.
- 1759 2. North Shore charged PEHS PPP billing charges below cost by  
1760 not increasing those charges when postage rates increased.
- 1761 3. North Shore increased charges for repairs to customer-owned  
1762 piping to ratepayers more than double its costs and charged PEHS  
1763 PPP repairs charges at cost. This provided PEHS with a competitive  
1764 advantage by disadvantaging ratepayers.
- 1765 4. North Shore discriminated against ratepayers who did not  
1766 purchase PPP in the provision of repairs to customer-owned piping by  
1767 providing firm repairs services to PEHS but not ratepayers without  
1768 PPP.

1769

1770 **Q. What do you recommend regarding the Master AIA?**



1771 A. I strongly believe that the current set of AIAs does not adequately protect  
1772 the public interest and that modifications are necessary to prevent further  
1773 abuse. I recommend that the Commission increase its oversight of these  
1774 transactions going forward. Therefore I have the following  
1775 recommendations for the Commission:

1776 Rec. 1. Require that the Master Affiliated Interest Agreement ("Master  
1777 AIA"), that was approved in Docket No. 10-0408 be modified by adding a Rider  
1778 (Attach. AN) applicable to all Integrys Utilities in Illinois which stipulates that  
1779 the Companies will only provide services to and receive services under the  
1780 Master AIA from regulated affiliates (as outlined in Section C.I) and the  
1781 Companies will not provide services to nor receive services from unregulated  
1782 affiliates (as outlined in Section C.II). Thus, any interactions with any  
1783 unregulated affiliates, apart from the IBS Regulated AIA, would require direct  
1784 Commission approval.

1785 Rec. 2. Prohibit any affiliate or its agent from using information,  
1786 including but not limited to ratepayer lists, received or developed pursuant to  
1787 the provision of services to the Companies from soliciting, marketing or  
1788 otherwise attempting to provide any product or service directly or indirectly to  
1789 the Companies' ratepayers or providing such information to any third party  
1790 whether affiliated with the Companies or not.

1791 Rec. 3. Consider whether fines should be imposed upon the  
1792 Companies for specific Company actions set forth below which violated the  
1793 Act to discourage future improprieties by the Companies and/or other utilities.

1794

1795 **Q. Will your first recommendation significantly affect the Companies**  
1796 **operations?**

1797 A. No. The Companies have indicated that this change to the Master AIA  
1798 would not have a substantial impact on their operations because the  
1799 Companies receive most of their services from IBS under the IBS Reg AIA.  
1800 (Attach AM, Companies Response to Staff DR DAS-15.11(a), (b).) The only

|  
1801 services that they currently receive under the Master AIA are the  
1802 maintenance service that ITF performs on the Division Street CNG Station.

1803 (Attach AM, Companies Response to Staff DR DAS-15.11(d).)

1804

1805 **Q. Does this conclude your prepared direct testimony?**

1806 A. Yes.